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BEFORE THE ARIZONA CORPORATION C[OMMISSION]

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COMMISSIONERS
MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR APPROVAL OF THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC.	DOCKET NO. E-04204A-06-0783 **STAFF'S NOTICE OF FILING SURREBUTTAL TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Surrebuttal Testimony of Ralph C. Smith (Redacted Version)(Consultant - Larkin & Associates, Inc.); David C. Parcell (Consultant – Technical Associates, Inc.); Frank W. Radigan (Utilities Division); Julie McNeely-Kirwan (Utilities Division); and Bing E. Young (Utilities Division) in the above-referenced matter. An Unredacted version of Ralph C. Smith's Surrebuttal Testimony has also been provided under seal to the Commissioners, their Assistants, the assigned Administrative Law Judge and the parties that have signed the Protective Agreement in this case.

RESPECTFULLY SUBMITTED this 24th day of August 2007.

Maureen Scott

Maureen A. Scott, Senior Staff Counsel
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SURREBUTTAL

TESTIMONY

OF

RALPH C. SMITH

DAVID C. PARCELL

FRANK W. RADIGAN

JULIE MCNEELY-KIRWAN

BING YOUNG

DOCKET NO. E-04204A-06-0783

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED FINANCING

AUGUST 24, 2007

Smith

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED. FINANCING	DOCKET NO. E-04204A-06-0783

REDACTED

SURREBUTTAL

TESTIMONY

OF

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

AUGUST 24, 2007

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ATTACHMENTS

EXECUTIVE SUMMARY
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-0783

My Surrebuttal Testimony addresses the following issues:

- The Company's proposed revenue requirement.
- Adjustments to test year data.
- Rate base, including construction work in progress.
- Test year revenues (including number of customers and usage) and expenses.
- Depreciation rates.
- The Company's requested modifications to the Purchased Power and Fuel Adjustment Clause ("PPFAC") and Staff's recommendations for features to include in a new PPFAC for UNS Electric.
- The Company's proposed ratemaking treatment for a new peaking unit, the Black Mountain Generating Station ("BMGS").

My findings and recommendations for each of these areas are as follows:

- The Company's proposed revenue requirement of a base rate increase of $8.5 million is overstated. I recommend that UNS Electric be authorized a base rate increase of $3.668 million on adjusted fair value rate base.

- The following adjustments to UNS Electric's proposed original cost and fair value rate base should be made:

Summary of Staff Adjustments to Rate Base		**Original Cost**		**Fair Value**		
Adj. No.	Description		Increase (Decrease)		Increase (Decrease)	**Note**
B-1	Remove Construction Work in Progress	$	(10,761,154)	$	(10,761,154)	
B-2	Adjust CWIP for Plant in Service by End of Test Year	$	442,255	$	442,255	
B-3	Plant in Service Addition Subject to Reimbursement	$	-	$	-	Revised
B-4	Cash Working Capital - Lead/Lag Study	$	196,450	$	196,450	Revised
B-5	Accumulated Deferred Income Taxes	$	(161,555)	$	(161,555)	
	Total of Staff Adjustments	**$**	**(10,284,004)**	**$**	**(10,284,004)**	
	UNS Proposed Rate Base	$	140,991,324	$	177,802,341	
	Staff Proposed Rate Base	**$**	**130,707,320**	**$**	**167,518,337**	

- The following adjustments to UNS Electric's proposed revenues, expenses and net operating income should be made (amounts shown are impact on net operating income):

Summary of Staff Adjustments to Net Operating Income

Adj. No.	Description	Pre-Tax Revenue or Expense Adjustment	Net Operating Income Increase (Decrease)	Note
C-1	Revenue Adjustment for CARES Discount	$ (52,937)	$ 32,504	
C-2	Remove Depreciation & Property Taxes for CWIP	$ (689,512)	$ 423,374	
C-3	Depreciation & Property Taxes for CWIP Found to be In-Service in the Test Year	$ 26,582	$ (16,322)	
C-4	Fleet Fuel Expense	$ (62,197)	$ 38,190	Revised
C-5	Postage Expense	$ 17,503	$ (10,747)	
C-6	Normalize Injuries and Damages Expense	$ (159,063)	$ 97,668	
C-7	Incentive Compensation Expense	$ (44,001)	$ 27,017	
C-8	Supplemental Executive Retirement Plant (SERP) Expense	$ (83,506)	$ 51,274	
C-9	Stock Based Compensation Expense	$ (82,873)	$ 50,886	
C-10	Property Tax Expense	$ (59,747)	$ 36,686	
C-11	Rate Case Expense	$ (111,667)	$ 68,566	
C-12	Edison Electric Institute Dues	$ (8,470)	$ 5,201	
C-13	Other Membership and Industry Association Dues	$ (6,482)	$ 3,980	
C-14	Interest Synchronization	$ -	$ (177,611)	Revised
C-15	Depreciation Rates Correction	$ (63,105)	$ 38,748	
C-16	Emergency Bill Assistance Expense	$ 20,000	$ (12,280)	
C-17	Markup Above Cost in Charges from Affiliate, SES	$ (10,906)	$ 6,697	Added
C-18	Bad Debt Expense	$ (155,609)	$ 95,547	Added
C-19	Remove Double Count from Outside Services-Demand Side Management	$ (17,055)	$ 10,472	Added
C-20	Correct Year-End Accrual Expense Amount for Out-of-Period Expense	$ (6,256)	$ 3,841	Added
Total of Staff's Adjustments		$ (1,549,300)	**$ 773,690**	
	Adjusted Net Operating Income per UNS Electric		$ 8,742,011	
	Adjusted Net Operating Income per Staff		$ 9,515,701	

- The new depreciation rates proposed by UNS Electric presented in Dr. White's Direct Testimony Attachment REW-2 should be adopted for use in this case, as corrected in the response to data request STF 11.8. The depreciation rates proposed by UNS Electric were generally developed in a manner that is consistent with the Commission's rules for depreciation rates.

- Each of the new depreciation rates proposed by UNS Electric should be clearly broken out between (1) a service life rate and (2) a net salvage rate. By doing this, the depreciation expense related to the inclusion of estimated future cost of removal in depreciation rates can be tracked and accounted for by plant account.

- In my Direct Testimony, Staff recommended that a new PPFAC for UNS Electric should be developed along the lines of the APS PSA Plan of Administration Staff proposed for the Arizona Public Service Company in Docket Nos. E-01345A-05-0816 et al, after appropriate adjustments to fit UNS Electric's circumstances. Staff and UNS Electric agree that a new PPFAC for UNS Electric should become effective June 1, 2008, upon expiration of the Company's all requirements power contract with PWCC. The new PPFAC proposed by UNS Electric in Exhibit MJD-3 to Mr. DeConcini's Rebuttal Testimony deviates from Staff's proposal and contains objectionable features such as inclusion of costs that would more appropriately be addressed in base rates, as well as raising other concerns, and should therefore be rejected. Staff's Draft Proposed Plan of Administration for UNS Electric

Purchased Power and Fuel Adjustment Clause (which is a Redline of UNS Electric Exhibit MDC-3) should be adopted instead.

- The Black Mountain Generation Station ("BMGS") is a 90 MW peaking plant which is being constructed in Mohave County by an affiliate, and which the Company projects will be in service around June 1, 2008 when the PWCC PSA expires. The in-service date for this plant is too far outside of the test year to qualify for base rate treatment in the current UNS Electric rate case. Staff believes that a more reasonable alternative approach to addressing the ratemaking and cash flow impacts of meeting UNS Electric's power supply will need to be developed. UNS Electric's proposed base rate treatment for BMGS in the current case should be rejected for the reasons described in my testimony, including the uncertainties presently existing with respect to this plant.

I. INTRODUCTION

Q. Please state your name, position and business address.

A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC, 15728 Farmington Road, Livonia, Michigan 48154. I am appearing on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. What is the purpose of the Surrebuttal Testimony you are presenting?

A. The purpose of my testimony is to address the revenue requirement and selected other issues, including changes to the Purchased Power and Fuel Adjustment Clause ("PPFAC") proposed by UNS Electric, Inc. ("UNS Electric" or "Company"), and the Company's proposed ratemaking treatment for a new peaking unit, the Black Mountain Generating Station ("BMGS") in the current rate case.

Q. Have you prepared any exhibits to be filed with your Surrebuttal Testimony?

A. Yes. Attachments RCS-6 through RCS-10 contain the results of my analysis and copies of selected documents that are referenced in my testimony.

Q. Are there outstanding data requests concerning the subject matter addressed in your Surrebuttal Testimony?

A. Yes. On August 16 and 17, 2007, Staff issued data request sets 20 and 21 to UNS Electric. As of the date of this writing (August 22, 2007) I had not received the Company's responses to those data requests.

II. REVENUE REQUIREMENT

Q. What issues are addressed in your Surrebuttal Testimony?

A. My testimony addresses the Company's proposed revenue requirement and selected other issues.

Q. What revenue increase has been requested by UNS Electric?

A. In its direct filing, UNS Electric requested an increase in base rate revenues of $8.507 million, or approximately 5.5 percent. As shown on Exhibit DJD-1, page 5 of 5, which was filed with UNS Electric witness Dallas Dukes' Rebuttal Testimony, the Company has revised its request to $8.487 million.

Q. What revenue increase does Staff recommend?

A. Staff recommends a revenue increase of $3.668 million on adjusted fair value rate base. The comparable base rate revenue increase calculated by Staff on original cost rate base is $3.647 million. This is shown on Schedule A of Attachment RCS-6, filed with my Surrebuttal Testimony. Attachment RCS-6 presents Staff's revised accounting schedules.

Return on Fair Value Rate Base

Q. How did Staff determine the return to be applied to the fair value rate base?

A. This is shown on Attachment RCS-6, Schedule D, and was addressed in my Direct Testimony and the Direct Testimony of Staff witness David Parcell.

Q. How did UNS Electric determine the rate of return to apply to fair value rate base in its filing?

A. As noted in my Direct Testimony, in UNS Electric's direct filing, as shown on Schedule A-1, the Company adjusted the return that is to be applied to fair value rate base downward, consistent with long-standing Commission practice, such that the revenue requirement produced by both the original cost rate base and the fair value rate base would not result in an excessive return on equity to the utility. UNS Electric's calculation of return on fair value rate base in the instant case is also consistent with the way the return was applied to the fair value rate base in the original rate case filing of its affiliate, UNS Gas, in Docket No. G-04204A-06-0463.

Q. Has UNS Electric presented a revised fair value rate base calculation in its Rebuttal Testimony?

A. No. UNS Electric's rebuttal filing includes a recalculation of its proposed revenue requirement at Exhibit DJD-1 (filed with Mr. Dukes' Rebuttal Testimony). Page 1 of that exhibit shows that the Company is applying its requested rate of return to its calculated original cost rate base to derive its proposed amount of required net operating income.

Q. Does UNS Electric criticize Staff's calculation of the return on fair value rate base in its Rebuttal Testimony?

A. Yes. Mr. Grant's Rebuttal Testimony at page 3, lines 2-5 states that: "Staff has proposed a methodology that is mathematically equivalent to the 'backing in' method that was expressly rejected in a recent Arizona Court of Appeals ruling involving Chaparral City Water Company ("Chaparral decision"). Staff's methodology should be rejected and replaced with a methodology that actually gives credence to FVRB in setting rates." He makes a similar assertion at page 33 of his rebuttal.

Q. Please respond to Mr. Grant's criticism.

A. A recent Court of Appeals decision provided guidance for calculating the return on fair value rate base. Staff's calculation has carefully considered and applied such guidance, whereas UNS Electric's filing has not. Moreover, Staff has selectively tested this methodology on some other Arizona utilities, and, in each instance tested, it produced a different revenue requirement than does the application of the rate of return to the utility's original cost rate base. More importantly, because there is appropriate economic and financial logic and support underlying the determination of the rate of return that Staff has applied to the FVRB, this approach cannot be dismissed as a mere superfluous mathematical exercise. The Court of Appeals clearly indicated that the Commission has the discretion to determine the appropriate methodology. Staff's position is that the proposed method of determining the rate of return that is applied to the FVRB is appropriate and is supported by valid economic and financial theory.

Q. Please elaborate upon the guidance that was provided by the Court of Appeals decision and how Staff's proposal has considered and reflected that guidance in its presentation in the current UNS Electric rate case.

A. First, the Court of Appeals specifically stated that the Commission was <u>not</u> bound to apply an authorized rate of return that was developed for use with an original cost rate base, without adjustment, to the fair value rate base. Page 9 of the Court of Appeals decision stated that: "Chaparral City ... asks that the Commission be directed to apply the 'authorized rate of return' to the fair value rate base rather than to the OCRB, as Chaparral City contends was done here." At page 13, paragraph 17, the Court of Appeals decision states as follows: "The Commission asserts that it was not bound to use the weighted average cost of capital as the rate of return to be applied to the FVRB. The Commission is correct." Thus, the Court of Appeals clearly stated that the Commission is <u>not</u> bound to apply to the FVRB the same weighted average cost of capital that was developed for application to the OCRB.

At pages 13-14, paragraph 17, the Court of Appeals decision stated that: "... the Commission cannot ignore its constitutional obligation to base rates on a utility's fair value. The Commission cannot determine rates based on the original cost, or OCRB, and then engage in a superfluous mathematical exercise to identify the equivalent FVRB rate of return. Such a method is inconsistent with Arizona law." At page 13, the decision states: "If the Commission determines that the cost of capital analysis is not the appropriate methodology to determine the rate of return to be applied to the FVRB, the Commission has the discretion to determine the appropriate methodology."

In view of the Court of Appeals decision in the Chaparral City case, Staff has appropriately adjusted the weighted cost of capital to the utility's fair value rate base. David Parcell's Direct Testimony in the instant rate case describes Staff's revision to the return on fair value rate base calculations in view of the recent Court of Appeals decision.

On Attachment RCS-6, Schedule D, I have derived the adjusted weighted cost of capital for application to the FVRB based on the recommendation of Staff witness Parcell. On Schedule A of that exhibit, I have applied Staff's adjustment to the weighted cost of capital as described by Mr. Parcell in his Direct Testimony. The cost of capital applicable to the amount of FVRB that is in excess of the OCRB is zero, since that rate base is not reported on the utility's financial statements and therefore has not been financed by any source of capital (such as debt or equity) that is reported on the utility's financial statements. As explained by Mr. Parcell, the financing cost rate for items in rate base that have not been financed with debt or equity on the utility's books, is zero. As shown on Attachment RCS-6, Schedule A, the application of Staff's adjusted weighted cost of capital to the FVRB results in revenue increase of $3.668 million. In this instance, the application of the adjusted weighted cost of capital to the FVRB produces a slightly higher revenue requirement than does the application of the unadjusted rate of return to OCRB.

III. RATE BASE

Q. In view of issues raised in UNS Electric's Rebuttal Testimony, have you made any revisions to Staff's proposed rate base?

A. Yes. After reviewing UNS Electric's Rebuttal Testimony, I have reflected adjustments for the following items:

- Staff is evaluating the removal of Staff Adjustment B-3 for a Customer Advance on a plant addition that was subject to reimbursement. UNS Electric witness Karen Kissinger explained in her rebuttal that the Company had received the advance, but had coded it incorrectly (to a different project) in its general ledger. Staff is awaiting the receipt of adequate supporting documentation to enable Staff's verification that the Customer Advance was recorded and netted against plant in service at the end of the test year. That documentation has been required in data request STF 20.50. If Staff determines that this adjustment is not necessary, it will be withdrawn.
- Updating cash working capital to reflect revised expenses on Schedule B-4.

Q. How does Staff's revised rate base compare with UNS Electric's proposed rate base?

A. A comparison of the proposed rate base identified in UNS Electric's rebuttal at Exhibit DJD-1, page 1 of 5, and Staff's recommended rate base on an Original Cost and Fair Value basis are presented below:

	UNSE (Revised)	Staff	Difference
Summary of Rate Base	Ex. DJD-1	Sch B (Revised)	
Original Cost Rate Base	$ 141,034,952	$ 130,707,320	$ (10,327,632)
Fair Value Rate Base	Not Updated	$ 167,518,337	N/A

The Company did not update its FVRB in Exhibit DJD-1.

The vast majority of the difference between the Company's proposed and Staff's recommended rate base relates to whether Construction Work in Progress should be included in rate base or not.

B-1 Construction Work in Progress

Q. As a result of UNS Electric's Rebuttal Testimony, has Staff revised its position concerning whether Construction Work in Progress should be included in UNS Electric's rate base in this case?

A. No. Staff continues to recommend that the $10.8 million of Construction Work in Progress ("CWIP") UNS Electric has proposed not be included in rate base because of the reasons described in my Direct and Surrebuttal Testimony. The Company has not justified including CWIP in rate base. Accordingly, Staff adjustment B-1 removes that amount of CWIP from rate base.

Q. Are you addressing any other aspects of the Company's proposal to include CWIP in rate base?

A. Yes. With respect to the issue of exclusion of CWIP from rate base, I am also addressing the related proposal of UNS Electric for inclusion of post-test-year plant in rate base, a Company proposal to continue accruing an Allowance for Funds Used During Construction ("AFUDC") on CWIP even if CWIP were to be included in rate base, and an issue concerning the appropriate ratemaking treatment of Customer Advances.

Q. Please summarize UNS Electric' rebuttal concerning the Company's proposal to include CWIP in rate base.

A. UNS Electric has proposed to include $10.761 million of "CWIP" in rate base. UNS Electric witness Kentton Grant presents the following reasons for why the Company believes CWIP should be included in rate base:

- While the rate base inclusion of CWIP is unusual in the sense that it has not been used for many years in Arizona, it is a tool that is available to the Commission for purposes of setting fair and reasonable rates.[1]
- Two Arizona Supreme Court cases in the 1970s discussed the inclusion of CWIP in rate base and indicated that the Commission could consider it in determining rates.[2]
- Mr. Grant selectively cites to certain cases in other jurisdictions where a state regulatory commission allowed a utility to include CWIP in rate base in order to maintain a utility's financial integrity.[3]
- There are "extraordinary circumstances" in the current case justifying the inclusion of CWIP in rate base because Mr. Grant claims "it will be very difficult, if not impossible, for the Company to earn its authorized rate of return over the next several years."[4]
- Inclusion of CWIP in rate base can be one means of addressing the "regulatory lag" issue for a utility with a large construction program.[5]
- An extension of time between rate case filings could be beneficial to the Company and its customers.[6]

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[1] Kentton Grant Rebuttal Testimony, page 9.
[2] Id., at page 9.
[3] Id, at pages 10-12.
[4] Id, at page 11.
[5] Id., at pages 16-17.
[6] Id., at pages 18. UNS Electric has not committed to any specific "stay out" period based on whether CWIP is or is not included in rate base in the current case.

Basically, these are not new arguments for inclusion of CWIP in rate base, but rather are a restatement of the Company's original request that CWIP be included in rate base in order to maintain the Company's financial integrity, to mitigate regulatory lag, to fund its rapid growth and to extend the period between rate cases.

Q. Mr. Grant's Rebuttal Testimony cites two Arizona Supreme Court cases in the 1970s that discussed the inclusion of CWIP in rate base. Has he demonstrated that the facts and circumstances of UNS Electric in the current case are similar to the specifics addressed in those cases?

A. No.

Q. At page 10 of his Rebuttal Testimony, Mr. Grant recommends applying a "financial integrity test" which would determine whether CWIP should be included in rate base or not. Has UNS Electric demonstrated that including CWIP in rate base is necessary in order to preserve its financial integrity?

A. I don't believe so. UNS Electric is experiencing rapid growth in customers, but it is not in financial distress. Staff witness David Parcell describes in his Direct and Surrebuttal Testimony how Staff's recommendations concerning cost of capital should permit UNS Electric to raise capital on reasonable terms. At page 27 of his Rebuttal Testimony, at lines 8-12, Mr. Grant agrees with Mr. Parcell's conclusion that CWIP is not necessary for UNS Electric to attract capital, and concedes that: "over the short-term, assuming no significant changes occur in the capital markets, that UNS Electric could probably attract additional capital without having CWIP in rate base." Staff witness Alexander Igwe has recommended in his Direct Testimony that the Commission approve the Company's request for financing. Staff has also recommended adoption of a PPFAC mechanism for UNS Electric that includes a forward-looking component, which, prospectively, should help match the Company's recovery of fuel and purchased power expense in the designated FERC accounts with the incurrence of such expense. Consequently, given the facts and circumstances of this case, the Company has not justified including CWIP in rate base and its request for CWIP in rate base should be denied.

Q. Please comment upon the use of financial projections by Mr. Grant as support for his arguments that CWIP should be included in rate base.

A. Mr. Grant appears to be relying on financial forecasts on pages 16 and 28-33 and elsewhere in his Rebuttal Testimony. I would caution against placing much reliance upon forecasts as the basis for ratemaking treatments, such as the CWIP issue in the current case. Forecasts are subject to change and can be inaccurate.[7]

At page 28 of his Rebuttal Testimony, Mr. Grant purports to recalculate his financial forecast and key financial indicators for UNS Electric based on inputting a $4.7 million reduction to the Company's requested revenue increase. However, to merely input a revenue difference without also reflecting the impact of the specific adjustments which cause that difference (i.e., without also reflecting the reasons for the difference) is questionable and unlikely to produce reliable forecasts that are meaningful and relevant for ratemaking purposes. In states that utilize future test years, where projections are made beyond the historical period, adjustments are not just made to revenues but to all of the components of the ratemaking formula which impact the level of revenues. In jurisdictions that utilize future test years, when adjustments are made for disallowed expenses, the disallowed expenses are removed from the future test year. To the extent that Mr. Grant is attempting to use his revised financial forecasts as some kind of

[7] Mr. Grant's rebuttal, at page 18, states that in 2003, the Company could not foresee the amount of capital investment needed to serve customer growth and system improvement needs, and that "it was difficult to predict the future impact of regulatory lag on UNS Electric."

surrogate for a future test year, or as some kind of test of the reasonableness of the parties' differing recommendations, his comparisons do not appear to reflect the adjustments to rate base or expenses that contribute to Staff recommending a different level of revenue increase than has been requested by the Company.

Q. Please discuss the issue of regulatory lag as it relates to the CWIP issue and to utility ratemaking in Arizona.

A. In Arizona, a historic test year with pro forma adjustments is used to establish utility rates. This approach has been employed for many years, and primarily without the inclusion of CWIP in utility rate base. The use of a test year, with appropriate adjustments, is intended to assure that the elements of the ratemaking formula are in balance. Regulatory lag refers to the difference in time between the test year and the rate effective date. My understanding is that it has always existed as an integral part of rate of return-based public utility regulation in Arizona, and for that matter virtually all states. It is not a new phenomenon which would require a change in basic regulatory policy. Moreover, there are other aspects of regulatory lag that benefit the Company. These include expired amortizations and accumulated depreciation. The Company continues to earn a return on and receives a recovery of assets that have already been recovered.

Q. Is inclusion of CWIP in rate base up to the discretion of the Commission?

A. Yes, it is. Staff's understanding is, in specific instances, the Commission has allowed a utility to include CWIP in rate base, but the Commission's general practice has been to <u>not</u> allow CWIP to be included in rate base.

Q. How does Staff view the "burden of proof" UNS Electric would have to meet in order to have CWIP included in rate base?

A. As I noted in my Direct Testimony, the burden of proof is on UNS Electric to prove its revenue requirement. Where the Commission has a very well-established policy, such as the exclusion of CWIP from rate base, UNS Electric bears the burden to demonstrate that it is different in significantly important respects than the comparable circumstances in the other utility rate cases over the past decades where CWIP was excluded from rate base. In other words, UNS Electric must show how it is different from the normal circumstances of a regulated Arizona public utility where CWIP has been excluded from rate base. In the current case, UNS Electric has failed to do this.

In this case, UNS Electric, Staff and RUCO have all acknowledged that the Commission's policy and practice has been to exclude CWIP from rate base. My Direct Testimony presented a number of reasons why CWIP has been excluded from rate base, which apply to CWIP in general as well as to UNS Electric in the current case. Mr. Grant's Rebuttal Testimony at page 34 does not refute these reasons. In fact, he indicates that two of the reasons are obvious: (1) that CWIP in rate base is not normally allowed by the Commission, and (2) that projects included in the test year CWIP balance were not in service as of the test year. He has also failed to demonstrate that post-test year revenue increases and expense reductions enabled by the CWIP have been properly identified and quantified by the Company and used as an offset to the revenue requirement impact of including CWIP in rate base. Consequently, the Company's proposal fails the matching principle. Nor has Mr. Grant demonstrated that UNS Electric is in financial distress, that it cannot continue to attract capital at favorable terms if CWIP continues to be excluded from rate base, or that UNS Electric is fundamentally different in terms of its customer growth and regulatory lag situation than the other major utilities in Arizona which do not have CWIP included in rate base.

Q. Based on your review of the reasons presented by UNS Electric in its Direct and Rebuttal Testimony and other factors, should CWIP be included in rate base in the current case?

A. No. In general, Staff does not favor inclusion of CWIP in rate base unless the utility demonstrates compelling reasons to justify this exceptional ratemaking treatment. For the following reasons, Staff does not support UNS Electric' request for rate base inclusion of CWIP in the current case:

1) Inclusion of CWIP in ~~rate base is an exception to the Commission~~'s normal practice, and UNS Electric has not met its burden of proof showing why it requires such an exceptional ratemaking treatment. UNS Electric has not demonstrated that it is in financial distress, or that it would be unable to obtain financing at a reasonable cost if the normal practice of excluding CWIP from rate base is followed in the current case. Staff witness David Parcell addresses how Staff's recommendations should enable UNS Electric to continue to have access to financing at a reasonable cost. Mr. Parcell also addresses the determination of a fair rate of return that would allow UNS Electric to attract new capital on reasonable terms. In making his cost of capital recommendations, Mr. Parcell has been made aware of and has taken into consideration UNS Electric' proposal to include CWIP in rate base and Staff's recommendation that CWIP not be included in rate base in this case.

2) The CWIP was not in service at the end of the test year. As of June 30, 2006, the construction projects were not serving customers.

3) The Company has not demonstrated that its June 30, 2006 CWIP balance was for non-revenue producing and non-expense reducing plant. Much of the construction appears to be for plant related to serving customer growth, i.e., to be revenue producing. Test year revenues have been annualized to year-end customer levels. However, revenues have not been extended beyond the test year to correspond with customer growth. Hence, including the investment in rate base, without recognizing the incremental revenue it supports, would be imbalanced. Some of the facilities that are being constructed will be used subsequent to the test year ending June 30, 2006 to serve additional customers. It would not be appropriate to include the investment that will serve those new customers without also including the revenues that would be received from those customers. In other words, allowance of CWIP in rate base would result in a mismatch in the ratemaking process. Additionally, some of the plant being added could result in a reduction in maintenance expenditures which would not be reflected in the test period. The inclusion of CWIP in rate base, therefore, creates an imbalance in the relationships between rate base serving customers and the revenues being provided to the utility from customers who were taking service during the test year. Consequently, CWIP should not be allowed in rate base unless there are very compelling circumstances which would warrant an exception to the general rule.

4) UNS Electric accrues a return, representing its financing costs during the construction period, called AFUDC. This AFUDC return accounts for the utility's financing cost during the construction period.

5) Other large Arizona utilities are also facing customer growth and similar "regulatory lag" issues to UNS Electric. Yet, to the best of my knowledge, none of the large Arizona utilities have CWIP in rate base. UNS Electric has failed to demonstrate that

its circumstances are so different and unique that it requires a significantly different regulatory treatment for CWIP.

6) While the Company has stated that inclusion of CWIP in rate base could result in deferring the filing of its next rate case, the Company has made no specific enforceable commitments to a filing moratorium period.

In summary, in the current case, UNS Electric has not demonstrated convincingly that it requires an exception to the Commission's standard ratemaking treatment of excluding CWIP from rate base.

Q. If CWIP were to be included in rate base, as requested by the Company, what is the UNS Electric rebuttal position concerning whether the accrual of AFUDC should cease?

A. This issue is addressed in Mr. Grant's rebuttal at page 35-36. As Mr. Grant recognized on page 14, lines 10-12, of his Rebuttal Testimony in the recent UNS Gas rate case[8] (but fails to mention in his Rebuttal Testimony in the current UNS Electric rate case), "the accounting guidelines published by the FERC require utilities to subtract the amount of any CWIP allowed in rate base from the balance of future CWIP eligible for AFUDC accruals." However, contrary to these rules, Mr. Grant attempts to carve out an exception for UNS Electric to this required accounting for AFUDC. He states that, because there is only a small amount of AFUDC on the test year balance of CWIP, it would be unfair to require UNS Electric to cease accruing AFUDC on $10.8 million of CWIP on an ongoing basis. If the Commission grants the Company's request to include CWIP in rate base, Mr.

[8] Docket Nos. G-04204A-056-063 et al.

Grant requests that language be included in the order that authorizes the Company to continue accruing AFUDC on all eligible construction projects.

Q. Does Staff agree with this proposal by Mr. Grant to continue accruing AFUDC even if CWIP were to be included in rate base?

A. No. Mr. Grant's proposal to continue accruing AFUDC on CWIP should be rejected because it is contrary to the accepted accounting guidelines and would result in a double recovery of the financing cost of CWIP. The financing cost for CWIP can be addressed for ratemaking purposes in one of two ways: (1) through the inclusion of CWIP in rate base for a current cash return, or (2) through the accrual of AFUDC, which is added to the construction cost and is ultimately included in the cost of plant and depreciated. It would be improper to give UNS Electric both a cash return on CWIP through its inclusion in rate base and an AFUDC return. If CWIP were to be allowed in rate base, which the Staff is not recommending in this case, then AFUDC accruals on the amount of CWIP included in rate base must cease.

Q. Does Staff agree with UNS Electric' alternative proposal to include post-test year plant additions in rate base, if the inclusion of CWIP in rate base is denied?

A. No. Making the CWIP adjustment in a slightly different format, by adding post-test year plant into rate base, also suffers from the same flaws as the Company's proposal to include CWIP in rate base. It is imbalanced because it fails to capture any post-test year revenue growth and maintenance expense decreases enabled by the new plant. Consequently, for reasons similar to the ones described above, Staff does not agree with UNS Electric's proposed alternative of including post-test year plant additions in rate base.

Q. At pages 34-35 of his Testimony, Mr. Grant recommends removing Customer Advances of approximately $1.9 million from rate base, if CWIP is excluded. Does Staff agree with this UNS Electric proposal?

A. No. Customer Advances should be reflected as a deduction from rate base. Customer Advances represent non-investor supplied capital, and therefore should be reflected as a deduction to rate base. Mr. Grant has not cited any prior Arizona utility rate case in which CWIP was excluded from rate base and Customer Advances were not reflected as a reduction to rate base to recognize the non-investor provided cost-free capital. Nor is Staff aware of an instance for any major Arizona public utility where CWIP was excluded from rate base and Customer Advances were not reflected as a deduction to rate base. The Commission's rules (A.A.C. R14-2-103, Appendix B, Schedule B-1) require that Customer Advances be reflected as a deduction from rate base.

One additional reason why Customer Advances should be deducted from rate base is to prevent a double rate of return. In accruing AFUDC by applying the AFUDC rate to a CWIP balance, Customer Advances are typically not deducted from the construction cost base upon which AFUDC is computed. If the Customer Advances have not been specifically deducted in the AFUDC calculations (which would be contrary to the prescribed treatment for a utility following the AFUDC formula in the FERC Uniform System of Accounts), the non-investor provided cost-free capital in the form of Customer Advances needs to be reflected as a rate base deduction.

Consequently, the request by Mr. Grant to adjust the balance of Customer Advances, if CWIP is excluded from rate base, is contrary to precedent, would be improper for ratemaking purposes, and should be rejected.

Q. Does Staff's adjustment to remove CWIP from rate base affect UNS Electric's expenses?

A. Yes. UNS Electric had proposed to treat CWIP at the end of the test year as if it were plant in service. Consistent with that, UNS Electric proposed increases to depreciation and property tax expense. Consistent with Staff's recommendation that CWIP not be included in rate base, Staff adjustment C-2, which was described in my Direct Testimony, has removed the related UNS Electric adjustments for depreciation and property tax expense.

B-3 Plant in Service Addition Subject to Reimbursement

Q. Please discuss the Company's rebuttal concerning a Customer Advance related to the Tubac Golf Resort Overhead to Underground Conversion project.

A. As described in my Direct Testimony, Staff's inspection of the Tubac Golf Resort Overhead to Underground Conversion (task CE64023) with a cost of $236,874 had the appearance of a project that should be reimbursed, at least in significant part by the customer, since it involved the removal of an overhead 13 kV line and installation. UNS Electric had advised Staff that the project appeared to be reimbursable to some extent, but was not able to provide documentation of the customer reimbursement. Ms. Kissinger's rebuttal explained that the related Customer Advance had been recorded by the Company by the end of the test year (but had been mis-coded to a different project). However, her Rebuttal Testimony did not appear to include adequate documentation for Staff to verify this.

As indicated in my Direct Testimony, if the CIAC had been recorded by UNS Electric by June 30, 2006, the adjustment shown on Schedule B-3 would not be necessary and should be withdrawn. For purposes of recalculating the rate base and revenue requirement in

Attachment RCS-6, I have removed adjustment B-3. However, if the requested information is not provided, this adjustment may be restored.

Q. Based on the supporting information and explanations presented by UNS Electric in Ms. Kissinger's Rebuttal Testimony, is Staff withdrawing this adjustment?

A. Based on the explanations in Ms. Kissinger's Rebuttal Testimony, Staff is currently evaluating whether this adjustment should be withdrawn. Staff is awaiting the receipt of adequate supporting documentation, which has been requested in data request STF 20.50.

B-4 Cash Working Capital

Q. Have you revised Staff's calculation of the working capital allowance?

A. Yes. On Schedule B-4, Revised, I have updated Staff's calculation of cash working capital for the impact of revised operating expenses.

B-5 Accumulated Deferred Income Tax

Q. Is there a difference between Staff's and the Company's proposed amount of rate base deduction for Accumulated Deferred Income Taxes ("ADIT")?

A. Yes. Staff has made an adjustment (which was described in my Direct Testimony and shown on Schedule B-5) to decrease rate base by $161,555 for the impact of the following:

1) removal of the ADIT related to the Supplemental Executive Retirement Plan ("SERP")[9]; and
2) removal of the ADIT relating to stock-based compensation.[10]

[9] See Staff Adjustment C-8 that has removed the expense related to SERP.
[10] See Staff adjustment C-9 that removes the expense for stock-based compensation.

This adjustment to ADIT is necessary to properly coordinate the impact of Staff's related adjustments to operating expenses with the ADIT amount included in rate base. Whether the rate base adjustment to ADIT should be made is dependent upon whether the related adjustments to operating expense are used.

IV. ADJUSTMENTS TO OPERATING INCOME

Q. As a result of additional review of information, including the UNS Electric rebuttal, have you revised Staff's proposed net operating income?

A. Yes. Attachment RCS-6, Schedule C summarizes Staff's revised recommended net operating income. Schedule C.1, present Staff's recommended adjustments to test year revenues and expenses on an Arizona jurisdictional basis. The impact on state and federal income taxes associated with each of the recommended adjustments to operating income are also reflected on Schedule C.1. UNS Electric's originally proposed adjusted test year net operating income is $8.742 million[11], whereas Staff's revised recommended adjusted net operating income is $9.516 million. The recommended adjustments to operating income are discussed below in the same order as they appear on Schedule C.1.

C-1 Revenue Adjustment for CARES Discount

Q. Has any revision to Staff Adjustment C-1 be made as a result of the UNS Electric rebuttal?

A. No. This adjustment removes UNS Electric's proposed adjustment to reduce electric retail revenue by $52,937 relating to a change proposed by the Company concerning how the discounts for CARES customers are calculated. As explained in the testimony of Staff witness Julie McNeely-Kirwan, Staff disagrees with that Company proposal and recommends that the existing discount rate structure for CARES be retained. Staff has

[11] Mr. Dukes' Rebuttal Exhibit DJD-1 shows that the Company has revised this to $8.759 million.

reflected its recommendations concerning the CARES discounts in the Staff proposed rate design.

C-2 Remove Depreciation and Property Taxes for CWIP

Q. Was Staff Adjustment C-2 revised as a result of the UNS Electric Rebuttal Testimony?

A. No. This adjustment removes the pro forma amounts calculated by UNS Electric for depreciation and property taxes related to the Company's proposal to include CWIP in rate base. As explained above[12], Staff disagrees with the Company's proposal to include CWIP in rate base. Accordingly, Staff has also removed the pro forma depreciation and property tax expense adjustments proposed by UNS Electric. As shown on Schedule C-2, this reduces the Company's proposed expenses for depreciation by $449,816 and property taxes by $239,696, for a total reduction of $689,512.

C-3 Depreciation and Property Taxes for CWIP Found to Be In-Service in the Test Year

Q. Was Staff adjustment C-3 revised as a result of the UNS Electric rebuttal?

A. No. This adjustment relates to rate base adjustment B-2. As described above in conjunction with Staff adjustment B-2, Staff's engineering and used-and-useful review revealed that a project that UNS Electric had included in CWIP was actually in service in May, 2006, and thus qualifies as plant in service. This adjustment increases recorded test year expenses to provide for depreciation and property taxes related to a project that UNS Electric had included in CWIP, Rhodes Homes (task 8009729), with a cost of $442,255 that was inspected by Staff on June 6, 2007, and was found to be in service on May 26, 2006, which was prior to the end of the test year.

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[12] See above discussion in conjunction with Staff Adjustment B-1.

Q. Does UNS Electric appear to agree with this adjustment in principle?

A. Yes. While UNS Electric would prefer to have all CWIP included in rate base (a proposal with which Staff disagrees), the Company has indicated in Ms. Kissinger's Rebuttal Testimony at pages 3-4 that it accepts Staff Adjustments B-3 and C-3 for recognizing plant that was placed into service by the end of the test year, and the related impact on expense.

C-4 Fleet Fuel Expense

Q. Have you revised Staff Adjustment C-4 for fleet fuel expense?

A. Yes. The documentation presented in Mr. Dukes' rebuttal workpapers on page UNSE(0783)10597 shows a total fleet fuel expense of $585,210 for the 12-month period July 2006 through June 2007, one full year after the test year. That workpaper, which is reproduced in Attachment RCS-8, also shows total gallons of 207,310 for that 12 month period. This actual information calls into question the accuracy of the Company's proposed pro forma calculation method (which was also followed by Staff and RUCO in their respective direct filings) for adjusting the quantity of gallons purchased. The Company's as-filed direct adjustment, and the Staff and RUCO pro forma calculations, which had accepted that part of the Company's calculation, resulted in pro forma gallons purchased of approximately 214,500 gallons. If the cost per gallon is going to be adjusted for a full year of post-test year pricing, the related pro forma quantity of gallons of fuel purchased should also be adjusted to correspond with the price data. Accordingly, as shown on Schedule C-4, revised, Staff has revised this adjustment to use 207,310 gallons at $2.82 per gallon, for a pro forma fleet fuel cost of $585,210.

UNS Electric's originally proposed adjustment is reduced by $62,197, as shown on Schedule C-4 (Revised).

C-5 Postage Expense

Q. Is there any remaining dispute between UNS Electric and Staff concerning normalized postage expense?

A. No. UNS Electric has adopted the adjustment shown on Schedule C-5, which increased UNS Electric's proposed amount of postage expense by $17,503 to reflect a known increase that became effective in May 2007.

C-6 Normalize Injuries and Damages Expense

Q. Has UNS Electric agreed with a portion of Staff Adjustment C-6?

A. Yes. In Mr. Dukes' Rebuttal Testimony at page 5, lines 16-25, UNS Electric agrees that the workers' compensation portion of injuries and damages expense is abnormally high during the test year and should therefore be reduced by $79,978. At page 5, lines 20-22, Mr. Dukes states that: "It does appear that the test-year amount of $173,456 is abnormally high due to the timing of when activity was actually expensed."

Q. Does Staff accept the adjustment proposed by Mr. Dukes of $79,978 for the workers' compensation portion of injuries and damages?

A. No. Mr. Dukes proposed adjustment is based on a test year expense of $173,456 for workers' compensation, which appears to understate the actual test year expense and is inconsistent with information provided by the Company concerning test year workers' compensation expense in response to data requests, such as STF 3.102 and STF 11.16.

Moreover, the remaining expense in Account 925, after making Mr. Dukes' proposed adjustment would appear to substantially exceed a normalized level.

Q. What other concerns does Staff have about the amount of injuries and damages expense proposed by UNS Electric?

A. Staff has continuing concerns about the total of Account 925 for the test year not being representative of normal, ongoing activity, and with respect to the remaining items in the account, including the Company's expense for Directors' and Officers' Liability ("D&O") Insurance, which is recorded in Account 925 and has been increasing substantially, from $22,032 in 2004, to $88,605 in 2005, to $130,330 in 2006, as listed in the responses to data requests STF 3.102 and STF 11.16. Mr. Dukes' Rebuttal Testimony at page 4, lines 25-26, explains that "that dramatic increase was caused by the fact that this coverage was not allocated to UNSE in 2004 and only partially in 2005." Staff is reviewing the workpapers and supporting documentation that UNS Electric has supplied after the filing of Mr. Dukes' Rebuttal Testimony, but has not yet completed that review. Staff has also reviewed the total amount recorded in Account 925 for the 12 month period following the test year, i.e., for the 12 months ending June 30, 2007, however, and that amount supports the overall reasonableness of Staff's recommended normalized allowance.

Q. What was the total amount in Account 925 for the 12 months ending June 30, 2007?

A. The total amount of expense in Account 925 for the 12 months ending June 30, 2007 listed on Company workpaper UNSE(0783)10737 was $398,032.

Q. How does that amount compare with Staff's recommended normalized amount?

A. Staff's recommended normalized amount for this account is $403,340, as shown on Schedule C-6. The Company's actual expense for the 12 months following the test year of $398,032 is $5,308 <u>less</u> than Staff's recommended normalized allowance.

Q. What do you recommend?

A. I continue to recommend a normalized level of expense for Account 925 of $403,340.

C-7 Incentive Compensation

Q. As a result of UNS Electric's Rebuttal Testimony, is any revision being made to Staff Adjustment C-7?

A. No. This adjustment removes 50% of the expense related to the various incentive compensation programs in effect at UNS Electric. In general, incentive compensation programs can provide benefits to both shareholders and ratepayers. The removal of 50% of the incentive compensation expense, in essence, provides an equal sharing of such cost, and therefore provides an appropriate balance between the benefits attained by both shareholders and ratepayers. Both shareholders and ratepayers stand to benefit from the achievement of performance goals; however, there is no assurance that the award levels included in the Company's proposed expense for the test year will be repeated in future years.

The adjustments to expense for each of UNS Electric's incentive compensation programs are shown on Schedule C-7. The adjustment reduces O&M expense by $42,448. A related impact on payroll tax expense reduces that by $1,553.

Q. What is the UniSource Energy Corporation's Performance Enhancement Program?

A. UNS Electric participates in the same incentive compensation arrangement, the Performance Enhancement Plan ("PEP"), as its affiliate, UNS Gas. As explained in the Company's supplemental response to data request STF 11.5 in the recent UNS Gas rate case, Docket Nos. G-04204A-06-0463 et al, the utility's non-union employees participate in UniSource Energy Corporation's PEP. UniSource Energy Services ("UES") is a subsidiary of UniSource Energy Corporation and the parent company of UNS Electric. The structure of the PEP determines eligibility for certain bonus levels by measuring UES' performance in three areas: (1) financial performance; (2) operational cost containment; and (3) core business and customer service goals. Levels of achievement in each area are assigned percentage-based "scores." Those scores are combined to calculate the final payout. The amount made available for bonuses pursuant to the PEP formula may range from 50 percent to 150 percent of the targeted payment level. The financial performance and operational cost containment components each make up 30 percent of the bonus structure, while the core business and customer service goals account for the remaining 40 percent. Additional information concerning the PEP was discussed in my Direct Testimony.

Q. What arguments does Mr. Dukes present in his Rebuttal Testimony for why the costs of UniSource Energy Corporation's Performance Enhancement Program should be fully charged to ratepayers?

A. At page 6 of his rebuttal, Mr. Dukes claims that the evidence he discusses in his Rebuttal Testimony shows that UNS Electric's total employee compensation including the PEP program is reasonable. At page 7 of his rebuttal, he claims that the PEP program costs "are actually a net savings to customers." He claims that "the goals and targets of the current PEP program are also heavily weighted toward providing benefits to customers." At page 8, he claims that "if the PEP program is eliminated, there would be considerable increased pressure on base compensation." At page 9 of his rebuttal, Mr. Dukes claims that direct savings result because PEP is not part of base compensation, and "the impact of reduced compounding wage increases that would be based on a higher base pay total is another benefit." At page 10, he cites a Commission Decision No. 69663 in a recent Arizona Public Service Company rate case where cash-based incentive compensation expense was allowed. At pages 10-11 of his rebuttal, Mr. Dukes claims that UNS Electric's PEP incentive compensation is different than the Southwest Gas Corporation ("SWG") Management Incentive Plan ("MIP") because the SWG MIP appears limited to management personnel, whereas UNS Electric's PEP plan covers all non-union employees. He claims that the PEP is based on broader and more wide-ranging factors, of which financial performance is only part of the consideration. Finally, on pages 11-13, he selectively cites to a few decisions from other regulatory commissions where the cost of a utility incentive compensation program was allowed to be included in rates.

Q. Has Mr. Dukes demonstrated that PEP is a net savings to customers?

A. No. Mr. Dukes has not demonstrated that base salaries were reduced when PEP was implemented. Moreover, base salaries have continued to increase each year. Thus, the PEP expense is an additional cost to the base salaries and other employee benefits.

Q. How does the weighting of the PEP goals affect your analysis of how the incentive compensation cost should be shared between shareholders and ratepayers?

A. The specific design of the incentive compensation program is one factor to be considered in determining the appropriate sharing of the cost between shareholders and ratepayers. The PEP program uses financial performance measures weighted at 30 percent, operational cost containment weighted at 30 percent, and customer service goals weighted at 40 percent. Shareholders benefit from financial performance, and also benefit between rate cases from any operational cost containment that is produced. While a 60/40 or some other sharing allocation could be used for ratemaking purposes, the 50/50 sharing recommended by Staff considers that there is benefit to both shareholders and to customers, and is a reasonable allocation.

Q. Has the Company made PEP payouts even where the specified goals were not met?

A. Apparently yes. As explained in the Company's supplemental response to data request STF 11.5(c) in the recent UNS Gas rate case, Docket G-04204A-06-0463:

> "In 2005, PEP had a similar structure as 2004 with two primary goals. However, the primary financial goal was now a combined financial measure for UNS Electric, UNS Gas and TEP. The second primary goal measured UNS Electric financial performance, customer and reliability goals, integration goals, and safety and employee goals. Similar to the prior year, each of the two primary goals was weighted equally and PEP only paid if the primary financial goal was met. As stated in the response to STF 11.5 b, the 2005 primary financial goal was not met."

Even though the primary financial goal under the PEP was not met in 2005, incentive bonuses were paid. As explained in the utility's supplemental response to STF 11.5(b): in the recent UNS Gas rate case, Docket No. G-04204A-06-0463, which describes the same UniSource Energy PEP in which UNS Electric also participates:

> "... the financial performance goal, which was a trigger under the PEP program for UNS Electric, UNS Electric and Tucson Electric Power Company ("TEP"), was not met. The financial performance goal was not met, in part, because of unplanned outages at the coal generating units which required TEP to purchase power on the open market. In discussions with the Board of Directors, the desire was to recognize employee achievements distinct from financial measures. The Board deemed it appropriate to implement a Special Recognition Award to employees for achievements in 2005. Normally, PEP is paid at 50% to 150% of target; the Special Recognition Aware was paid at approximately 42% of the target for each of the operating companies."

Q. What evidence does Mr. Dukes rely upon for his claim that the compensation of employees who receive PEP incentive bonuses is reasonable?

A. At page 8 of his Rebuttal Testimony he references and appears to be relying upon Confidential Exhibit DJD-3 for this conclusion. However, that exhibit does not appear to include an evaluation of the compensation for all employees who are eligible to receive

PEP. After receiving Mr. Dukes' Rebuttal Testimony, Staff has requested clarification and additional information in discovery; however, responses have not yet been received.

Q. What does Mr. Dukes state is the Company's compensation philosophy?

A. At page 8, lines 12-13, Mr. Dukes states that: "The Company's compensation philosophy is to pay at approximately 50% of market rate for its employees."

Q. Is there evidence that this policy has not been followed?

A. At least with respect to executives, yes. In Confidential Attachment RCS-10, I have attached a copy of the "UniSource Energy Executive Compensation – Competitive Compensation Review" dated October 25, 2005 that was prepared by Frederic W. Cook & Co., Inc. (which was provided in a supplemental response to STF 22.10 in the recent UNS Gas rate case). That document indicates that **[REDACTED]**.

Q. At page 10 of his rebuttal, Mr. Dukes cited Commission Decision No. 69663 from a recent APS rate case where cash-based incentive compensation expense was allowed after it was not opposed by Staff in that case. Did Mr. Dukes' rebuttal fully address the analysis of incentive compensation contained in Commission Decision No. 69663?

A. No. It appears that Mr. Dukes may have cherry-picked one paragraph from that decision. However, in his Rebuttal Testimony, Mr. Dukes failed to mention that there was a disallowance made for incentive compensation in the APS rate case or the Commission's reasoning for that disallowance. In making the disallowance in the APS case, the Commission adopted a recommendation by Staff to disallow that company's stock-based compensation. Page 36 of Decision 69663 indicates that the Commission rejected an argument by APS that the Commission not look at how compensation is determined or its individual components:

> "APS argues that the issue is whether APS compensation, including incentives, is reasonable. APS does not believe that the Commission should look at how that compensation is determined or its individual components, but rather should just look at the total compensation. The Company argues that the interests of investors and consumers are not in fundamental conflict over the issue of financial performance, because both want the Company to be able to attract needed capital at a reasonable cost."
>
> "We agree with Staff that APS' stock-based compensation expense should not be included in the cost of service used to set rates. Contrary to APS' argument that we should not look at how compensation is determined, we do not believe rates paid by ratepayers should include costs of a program where an employee has an incentive to perform in a manner that could negatively affect the Company's provision of safe, reliable utility service at a reasonable rate." As testified to by Staff witness Dittmer and set out in Staff's Initial brief, "enhanced earnings levels can sometimes be achieved by short-term management decisions that may not encourage the development of safe and reliable utility service at the lowest long-term cost. ... For example, some maintenance can be temporarily deferred, thereby boosting earnings. ... But delaying maintenance can lead to safety concerns or higher subsequent 'catch-up' costs." [cite omitted] To the extent that Pinnacle West shareholders wish to compensate APS management for its enhanced earnings, they may do so, but it is not appropriate for the utility's ratepayers to provide such incentive and compensation."

Thus, in Decision No. 69663, the Commission did make an adjustment to disallow a portion of that utility's incentive compensation expense.

Q. At pages 10-11 of his rebuttal, Mr. Dukes claims that UNS Electric's PEP incentive compensation is different than SWG Management Incentive Plan ("MIP") because the SWG MIP appears limited to management personnel, whereas UNS Electric's PEP plan covers all non-union employees. Please respond.

A. The specific forms of incentive compensation may differ somewhat in the coverage or structure between utilities regulated by the Commission. Again, Staff is not proposing an adjustment to the UNS Electric incentive compensation solely because an adjustment was made to SWG's incentive compensation. Rather, based on the factual situation in the current case, a 50/50 sharing of the UNS Electric's PEP incentive compensation expense would appear to be fair and more appropriate than charging such expense 100 percent to ratepayers.

Q. Did the Commission disallow a portion of APS's and SWG's incentive compensation in each of their respective most recent rate cases?

A. Yes. The Commission disallowed a portion of APS's incentive compensation expense in Decision No. 69663 and disallowed a portion of SWG's incentive compensation in Decision 68487.

Q. Is Staff's recommended treatment of the PEP incentive compensation for UNS Electric consistent with the recommendation for this expense in the recent UNS Gas rate case?

A. Yes, it is. Staff sees no basis at this time for revising the recommendation that the cost of PEP be shared between ratepayers and shareholders.

Officer's Long-Term Compensation Program

Q. At pages 13-14 of his rebuttal, Mr. Dukes claims that long term incentive costs allocated to the Company from TEP for executive oversight of UNS Electric "represent a portion of the Officers' total compensation that is variable and put at risk, but are an integral part of a competitive compensation program. This *total compensation* is targeted at the median of the peer group as reviewed by an independent consultant on behalf of the Compensation Committee of the Board of Directors." He further claims that: "No party states that the package is unreasonable or excessive, or that refutes the evidence the Company provided that the costs are at the median of market and are necessary, reasonable and prudent cost incurred to attract and retain the Officer's (sic) of TEP and UNS Electric." Please respond.

A. Contrary to these assertions by Mr. Dukes, as shown in Attachment RCS-10, a recent executive compensation study shows the total compensation of officers **[REDACTED].** At page 8, lines 12-13 of his rebuttal, Mr. Dukes stated that: "The Company's compensation philosophy is to pay at approximately 50% of the market rate for its employees." Compensation that is substantially in excess of 50% of the market rate could presumably be viewed as unreasonable and even excessive. In addition to the reasons described in my Direct Testimony for disallowing this cost, an additional argument could be made that the compensation is in excess of 50% of the market rate, and consequently is excessive and should be borne by shareholders and not charged to ratepayers.

C-8 Supplemental Executive Retirement Program Expense

Q. In response to UNS Electric's Rebuttal Testimony, is any revision being made to Staff Adjustment C-8?

A. No. Staff's adjustment removes 100% of the expense for the Supplemental Executive Retirement Plan ("SERP"). The SERP provides supplemental retirement benefits for select executives. Generally, SERPs are implemented for executives to provide retirement benefits that exceed amounts limited in qualified plans by Internal Revenue Service ("IRS") limitations. Companies usually maintain that providing such supplemental retirement benefits to executives is necessary in order to ensure attraction and retention of qualified employees. Typically, SERPs provide for retirement benefits in excess of the limits placed by IRS regulations on pension plan calculations for salaries in excess of specified amounts. IRS restrictions can also limit the Company 401(k) contributions such that the Company 401(k) contribution as a percent of salary may be smaller for a highly paid executive than for other employees.

In Decision No. 68487, February 23, 2006, an SWG rate case, the Commission adopted a recommendation by RUCO to remove SERP expense. In reaching its conclusion regarding SERP, the Commission stated on page 19 of Order 68487 that:

> "Although we rejected RUCO's arguments on this issue in the Company's last rate proceeding, we believe that the record in this case supports a finding that the provision of additional compensation to Southwest Gas' highest paid employees to remedy a perceived deficiency in retirement benefits relative to the Company's other employees is not a reasonable expense that should be recovered in rates. Without the SERP, the Company's officers still enjoy the same retirement benefits available to any other Southwest Gas employee and the attempt to make these executives 'whole' in the sense of allowing a greater percentage of retirement benefits does not meet the test of reasonableness. If the Company wishes to provide additional retirement benefits above the level permitted by IRS regulations applicable to all other employees it may do so at the expense of its shareholders. However, it is not reasonable to place this additional burden on ratepayers."

The SERP expense at UNS Electric is not distinguishable in any material way from the SERP expense that was disallowed in the recent SWG rate case. Consequently, I continue to recommend the adjustment to remove UNS Electric's expense for the SERP, which is shown on Schedule C-8 and reduces O&M expense by $83,506.

C-9 Stock Based Compensation

Q. Has any revision been made to Staff Adjustment C-9 as the result of UNS Electric's rebuttal?

A. No. This adjustment decreases test year expense by $82,873 for the removal of stock-based compensation to officers and employees. The expense of providing stock options and other stock-based compensation to officers and employees beyond their normal levels of compensation should be borne by shareholders and not by ratepayers. The Commission recently disallowed APS's stock-based incentive compensation expense in Decision No. 69663.

At page 8, lines 12-13 of his rebuttal, Mr. Dukes states that: "The Company's compensation philosophy is to pay at approximately 50% of the market rate for its employees." Compensation that is substantially in excess of 50% of the market rate could presumably be viewed as unreasonable and even excessive. As shown in Attachment RCS-10, a recent executive compensation study suggests that the total compensation of officers **[REDACTED]**.

C-10 Property Tax Expense

Q. What response in rebuttal did UNS Electric present to Staff Adjustment C-10?

A. UNS Electric's Rebuttal Exhibit DJD-1, page 5 of 5 indicates that UNS accepts Staff's adjustment. This adjustment reflects the known statutory assessment ratio of 23.5 percent applicable for 2008, when rates in this case are expected to become effective. The Arizona State Legislature passed House Bill No. 2779 which set a new rate schedule for property tax assessments. The new assessment rate schedule provides for decreasing the 25 percent rate applicable in 2005 in 0.5 percent steps each year until a 20 percent rate is attained in 2015. The Company's calculation used a 24 percent assessment rate and thus failed to recognize the impact of this known tax change prospectively. Staff's recommended adjustment reduces UNS Electric's proposed property tax expense by $59,747.

C-11 Rate Case Expense

Q. Please discuss the allowance for rate case expense.

A. UNS Electric's filing requests an amount of $600,000 for rate case expense normalized over a three year period, for an annual allowance of $200,000 per year. Staff recommends an annual allowance of $88,333 per year, based on a total of $265,000 normalized over three years. The total amount of rate case expense requested by UNS Electric of $600,000 and the annual allowance of $200,000 per year over a three-year period appears to be excessive and would represent an unreasonable burden on ratepayers. The amount of $600,000 requested by UNS Electric is over 2.5 times as high as the amount of rate case expense allowed by the Commission in the Southwest Gas rate case, which was $235,000 in total, and which was normalized over a three-year period. Although Southwest Gas is a larger utility than UNS Electric, the current UNS Electric rate case has similarities to the Southwest Gas rate case in terms of both the scope of issues in the cases, and the majority of each application being sponsored by in-house or affiliated company staff. Staff Adjustment C-11 reduces the $200,000 annual amount that was requested in the Company's original filing for rate case expense by $111,667 to provide for an annual allowance of $88,333 per year.

Q. Does the fact that this is the first rate case for UNS Electric justify a $600,000 rate case expense?

A. No. While the current case may be the first rate case for this utility operation <u>under its current ownership</u>, it isn't the first rate case for this utility. This electric utility had periodic, recurring rate cases under its prior ownership by Citizens Utilities. The transfer of ownership should not be an excuse for charging ratepayers for what appear to be excessive amounts of rate case cost.

Q. At page 16-17 of his rebuttal, Mr. Dukes claims that SWG is not comparable to UNS Electric, because of the way in which SWG and TEP charge for shared services. Why does Staff view the SWG allowance for rate case expense to be a good guideline for UNS Electric?

A. Staff used the SWG rate case allowance as a reasonable benchmark for UNS Gas in that utility's recent rate case, Docket No G-04204A-06-463 et al. Moreover, the current UNS Electric rate case is similar to and presents many of the same issues, such as revisions to a PGA/PPFAC mechanism, adjustments to operating expenses for incentive compensation and SERP, etc., that were recently addressed by the Commission in Docket No. G-01551A-04-0876, a rate case involving a large gas distribution utility in the state, Southwest Gas Corporation. Consequently, Staff believes that the Southwest Gas case provides a reasonable benchmark for what a reasonable allowance for rate case cost should be in the current UNS Electric rate case.

Q. Is the current UNS Electric rate case the best forum for reviewing whether the allocation of TEP shared services cost should be revised?

A. No. Staff believes that the allocation of TEP shared services costs can best be reviewed in the current rate case that TEP has filed in Docket Nos. E-01933A-05-0402 et al. Staff would caution against attempting to allocate substantially higher amounts of TEP shared services cost to UNS Electric in the current case, where it cannot be adequately verified that such costs are being removed from TEP's expenses.

C-12 Edison Electric Institute Dues

Q. Please respond to UNS Electric's Rebuttal Testimony concerning Edison Electric Institute ("EEI") dues.

A. At page 17 of his rebuttal, Mr. Dukes concedes that "based on the historical standard of excluding lobbying cost we (UNS Electric) should have excluded the EEI Utility Air Regulatory Group ("UARG") dues. He argues against the exclusion of 49.93 percent of the EEI regular dues, however, on the grounds that the Company has provided extensive information on the benefits to customers through its EEI membership. He provided that information in Exhibit DJD-5 to his Rebuttal Testimony.

Q. What is provided in Mr. Dukes' Rebuttal Exhibit DJD-5?

A. It basically is a reproduction of the Company's response to data request STF 11.11. The benefits claimed by Mr. Dukes are apparently those listed in the response to STF 11.11, parts a and c. Those subparts had requested a listing of what EEI did during the test year to represent the interests of its members in advocating positions in the legislative and regulatory arenas and a statement of "exactly what advocacy activities before Congress and government agencies EEI engaged in during the test year." Neither UNS Electric nor its affiliates have performed a study or evaluation of whether its ratepayers are receiving a benefit from the EEI membership that is commensurate with the cost.[13]

[13] See, e.g., response to STF 11.11(f).

Q. Why should 49.93 percent of the regular EEI dues be disallowed?

A. Staff's adjustment reduces test year expense by $8,470 to reflect removal of 49.93 percent of EEI core dues and 100 percent of the EEI UARG dues. Staff's adjustment reflects the removal of 49.93 percent of EEI core dues based upon a classification by NARUC category for EEI Core Dues activities for the year ended December 31, 2005. This is shown on Schedule C-12, page 2. EEI Core Dues relating to the following activities should be excluded from rates:

- Legislative Advocacy
- Regulatory Advocacy
- Advertising
- Marketing
- Public Relations

The sum of EEI Core Dues activities for these NARUC categories totals 49.93 percent, as shown on Schedule C-12, page 2.

Q. What is the purpose of the NARUC-designated categorization of EEI expenditures?

A. The purpose of the NARUC-designated categorization of EEI expenditures is to provide regulatory commissions with information that is useful in helping them decide which, if any, of the costs of the association should be approved for inclusion in utility rates. Often, state commissioners review the costs of the association charged or allocated to the utilities in their jurisdiction in accordance with the policies of their commission for treatment of costs directly incurred by the state's utilities for similar activities. Certain expense categories may be viewed by some State commissions as potential vehicles for charging ratepayers with such costs as lobbying, advocacy or promotional activities which may not be to their benefit. The NARUC-designated categories of EEI expenditures are thus intended to be helpful to state utility regulatory commissions.

Q. Has Mr. Dukes addressed the NARUC categories of EEI expenses?

A. Not really. He appears to agree that the lobbying portion of EEI regular dues should be disallowed.

Q. Was this same percentage for the EEI core dues disallowance recently used in any other electric utility rate cases?

A. Yes. The Arkansas Public Service Commission in Docket No. 06-101-U, an Entergy Arkansas, Inc., rate case, in Order No. 10 (6/15/07) adopted a similar adjustment to reflect the disallowance of 49.93 percent of EEI core dues. This 49.93 percent disallowance of EEI core dues corresponds to the above-identified activity categories.

C-13 Other Membership and Industry Association Dues

Q. Has UNS Electric accepted Staff's proposed adjustment for Other Membership and Industry Association Dues.

A. Yes. Mr. Dukes' Rebuttal Exhibit DJD-1, page 3 of 6, states that: "UNS accepts ... the adjustment for $6,482 (C-13) for other membership and industry association dues."

C-14 Interest Synchronization

Q. Have you updated Staff's interest synchronization adjustment?

A. Yes. The interest synchronization adjustment applies the weighted cost of debt to the calculation of test year income tax expense. After adjustments, my proposed rate base differs from that of the Company. This results in an adjustment to the amount of synchronized interest included in the tax calculation. The revised calculation of the interest synchronization adjustment is shown on Schedule C-14 of Attachment RCS-6. This adjustment increases income tax expense by the amount shown on Schedule C-14 and decreases the Company' achieved operating income by a similar amount.

C-15 Depreciation Rates Correction

Q. Has UNS Electric accepted Staff Adjustment C-15 to correct depreciation expense?

A. Yes. UNS Electric has accepted Staff's adjustment to reduce annualized depreciation expense by $63,105 to correct the Company's proposed depreciation rate for transportation equipment. See Mr. Dukes' Rebuttal Exhibit DJD-1, page 5, and the Rebuttal Testimony of UNS Electric witness Karen Kissinger at page 2.

C-16 Emergency Bill Assistance Expense

Q. Has UNS Electric accepted Staff Adjustment C-16?

A. Yes. UNS Electric has accepted Staff's adjustment to increase test year expense to be included in the base rate revenue requirement determination by $20,000 to provide for an increase requested by the Company for emergency bill assistance.

Adjustments Not Quantified in Staff's Direct Filing

Q. Have you adjusted Staff's revenue requirement calculation for certain adjustments that were not quantified in Staff's direct filing?

A. Yes. As described below, I have adjusted Staff's revenue requirement calculation for adjustments to certain operating expenses that were not quantified in Staff's direct filing, but which have now been quantified. The need for Adjustment C-17 was discussed in my Direct Testimony. Adjustments C-18 through C-20 merely reflects Staff's acceptance of certain corrections and revisions for three items that UNS Electric has agreed with in its Rebuttal Testimony. Each of these adjustments is discussed below.

C-17 Markup Above Cost for Charges from Affiliate, Southwest Energy Services

Q. Your Direct Testimony at pages 42-43 described the need for an adjustment to remove a 10 percent mark-up above cost related to charges to UNS Electric for services provided by the affiliated company, Southwest Energy Services. Have you quantified an adjustment for this?

A. Yes. As shown on Schedule C-17, I have removed $10,906 of expense, which is the test year amount of mark-up related to SES charges that was stated in the Company's supplemental response to data request STF 15.1. UNS Electric's supplemental response to STF 15.1 identified that amount, but also stated that: "The mark-up represents 6.5% of the total billings." I should note that the $10,906 used in this adjustment may be understated and appears to represent considerably less than 6.5% of the total test year direct and indirect billings to UNS Electric from the affiliate, SES. Staff has issued a follow up data request STF 21.3 to obtain further information concerning this.

C-18 Bad Debt Expense

Q. Please describe your adjustment to Bad Debt Expense.

A. This adjustment was made to reflect Staff's acceptance of UNS Electric's revision to its Bad Debt Expense adjustment as referenced in Mr. Dukes' Rebuttal Testimony at pages 21 and 22. Mr. Dukes agreed with RUCO's adjustment to Bad Debt Expense to the extent that RUCO used net write-offs in its adjustment versus gross write-offs as the Company did in its initial adjustment. In addition, Mr. Dukes' used a three-year average of net write-offs in his revised Bad Debt Expense calculation. Therefore, as shown on Schedule C-18, I have reduced Bad Debt Expense by $155,609.

C-19 Remove Double Count from Outside Services - Demand Side Management ("DSM")

Q. Please explain your adjustment to Outside Services as it relates to DSM expenses.

A. This adjustment was made to reflect Staff's agreement with an error correction identified at page 27 of Mr. Dukes' Rebuttal Testimony related to the removal of test year expense related to DSM activity. RUCO recommended the removal of $49,920 from Outside Services that the Company paid to ECOS Consulting pursuant to it developing the Residential New Construction DSM Program (Energy Smart Homes)[14]. Mr. Dukes agreed that the amount should be removed as the Company is proposing to recover such costs separately through a DSM charge. Mr. Dukes indicated in his Rebuttal Testimony that $32,865 of these costs were already included in the Company's DSM and Renewables adjustment, but that the remaining costs should also be removed. Therefore, as shown on Schedule C-19, I have removed the remaining expense $17,055 from the Company's test year expense.

C-20 Correct Year-End Accrual Expense Amount

Q. Please explain your adjustment to Year-End Accruals.

A. This adjustment was made to reflect Staff's agreement with the Company's and RUCO's removal of a prior period expense that was incurred in April 2004, but not recorded by the Company to expense until August 2005, as referenced in Mr. Dukes' Rebuttal Testimony at page 22. Therefore, as shown on Schedule C-20, I have removed $6,256 from test year expense.

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[14] See Direct Testimony of RUCO witness Marylee Diaz Cortez at page 30.

Additional Adjustments Proposed by Company in Rebuttal

Q. Has UNS Electric proposed some additional adjustments in its Rebuttal filing?

A. Yes. UNS Electric witness Dukes proposes additional adjustments to increase test year operating expense for an overtime adjustment and for an additional payroll increase.

Q. Didn't the Company already have adjustments for payroll and overtime in its Direct filing?

A. Yes, it did. In UNS Electric's original filing, Mr. Dukes proposed an adjustment to increase payroll and overtime expense by $107,433.

Q. Was that adjustment contested by Staff or RUCO?

A. No. The adjustments for payroll and overtime in UNS Electric's direct filing were not contested by Staff. Mr. Dukes' Rebuttal Exhibit DJD-1, page 2 of 5, indicates that both Staff and RUCO accepted the Company's originally filed payroll expense adjustment of $107,433.

Q. How does the Company's newly proposed adjustment that was filed with the Company's Rebuttal on August 14, 2007 compare with the $107,433 payroll increase amount that was in the Company's original filing and was accepted by both Staff and RUCO?

A. As shown on Mr. Dukes' Rebuttal Exhibit DJD-1, page 2 of 5, the Company's new adjustment is now an increase of $339,184. This is an increase of $231,751 over the $107,433 payroll increase amount that was in the Company's original filing and was accepted by both Staff and RUCO. It more than triples the Company's original adjustment.

Q. Had Staff requested in discovery of UNS Electric to have the Company identify revisions and corrections to its filing?

A. Yes. In data request STF 3.88 Staff requested the following information: "As the Company discovers errors in its filing identify such errors and provide documentation to support any changes. Please update this response as additional information becomes available." The purpose of such discovery was to avoid surprise revisions.

Q. Did the Company identify any revisions and corrections to its filing in response to STF 3.88 related to payroll or overtime expense?

A. No. A copy of the Company's response to STF 3.88 is included in Attachment RCS-8. No adjustments to payroll or overtime expense were identified in that response.

Company's Proposed Overtime Adjustment

Q. At page 20 of his Rebuttal Testimony, Mr. Dukes asserts that he accepted Staff's adjustment for overtime expense in the UNS Gas case. In his Rebuttal, he is now proposing to revise the Company's overtime expense to use the same calculation for normalized overtime that was used in the UNS Gas case. Do you agree that an adjustment to overtime expense should be made for the UNS Electric using the same method you used to calculate an overtime adjustment for UNS Gas?

A. No. My analysis shows that while an adjustment to overtime expense was necessary for UNS Gas, the overtime reflected in UNS Electric's original filing is within a range of the results produced by the same calculations for normalized overtime that I used to calculate an overtime adjustment for UNS Gas. Consequently, no overtime adjustment is necessary for UNS Electric. My analysis of overtime expense for both companies is presented in Attachment RCS-9.

Q. Please discuss your analysis of overtime in the UNS Gas case and your similar analysis of overtime in the UNS Electric case.

A. Calculations considered in proposing an adjustment to test year overtime for UNS Gas and not proposing an adjustment to test year overtime for UNS Electric are presented in Attachment RCS-9. Pages 2 and 3 of Attachment RCS-9 reproduce, for ease of reference, my analysis of an overtime adjustment in the UNS Gas case, specifically, Schedule C-9, pages 1 and 2 from my revenue requirement exhibit (Attachment RCS-2), in that case. As shown, my recommendation for an adjustment to the Company's filed amount of overtime expense in the UNS Gas rate case was based upon two calculations, both of which confirmed the need for a downward adjustment. Schedule C-9, page 1, showed a reduction to overtime of $123,010 and Schedule C-9, page 2, showed a reduction of overtime expense of $138,876.

In contrast, the same two calculations for UNS Electric, which are shown on pages 4 and 5 of Attachment RCS-9, produced different results, one (on page 4) showed an increase of $64,222 and the other (on page 5) showed a $50,981 decrease. These workpapers were prepared under my supervision prior to Staff's direct filing in this case. Attachment RCS-9, page 6, lists the overtime results used, which were from Mr. Dukes' payroll expense workpapers. Consequently, because the results of my overtime analysis for UNS Electric bracketed the amount of overtime presented in UNS Electric's filing, I concluded that no adjustment to UNS Electric's filed overtime adjustment was necessary.

Q. Have you reflected Mr. Dukes' new proposed adjustment for overtime?

A. No. As described above, my analysis of overtime expense, which is presented in Attachment RCS-9, and which followed the same analysis format that I used in the UNS Gas case, indicates that the overtime expense in UNS Electric's original filing is within a range of reasonableness (i.e., it was bracketed by the results of the two alternative calculations I performed). Consequently, no additional adjustment to overtime for UNS Electric is necessary.

Company's Proposed Revision to Payroll Expense Adjustment

Q. Have you reflected Mr. Dukes' new proposed adjustment for payroll expense?

A. No. Due to the timing of when this adjustment was presented, coupled with the size of the change, I have not been able to fully evaluate whether Mr. Dukes' more than tripling of the Company's previously filed payroll and overtime expense adjustment, which had been accepted by both Staff and RUCO, is appropriate.

Q. Has Staff issued some discovery to obtain additional information that might be helpful in evaluating the Company's new revision to its payroll adjustment?

A. Yes. After receiving the Company's Rebuttal Testimony, Staff issued data request sets 20 and 21 to UNS Electric. Some of that requested information, which had not yet been received or reviewed as of the date of this writing, might be helpful in evaluating the Company's revised payroll expense adjustment.

V. DEPRECIATION RATES

Q. What recommendations did you make in your Direct Testimony concerning the depreciation rates proposed by UNS Electric?

A. I recommended that the new depreciation rates proposed by UNS Electric be adopted, subject to correcting an error in the rates for transportation equipment.

I also recommended that each of the new depreciation rates proposed by UNS Electric should be clearly broken out between (1) a service life rate and (2) a net salvage rate. By doing this, the depreciation expense related to the inclusion of estimated future cost of removal in depreciation rates can be tracked and accounted for by plant account.

Q. Has UNS Electric's rebuttal caused you to change either of these recommendations?

A. No. UNS Electric agreed with my recommended correction to the depreciation rates for transportation equipment. Additionally, UNS Electric has offered no valid reason why it should not be required to clearly break out the depreciation rates between (1) a service life rate and (2) a net salvage rates, which will enable tracking of the depreciation expense related to the inclusion of estimated future cost of removal in depreciation rates can be tracked and accounted for by plant account.

VI. CHANGES TO PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE

Q. What recommendations did Staff make in your Direct Testimony concerning the revised PPFAC that UNS Electric had proposed?

A. I recommended that the PPFAC proposed by UNS Electric in its direct filing be rejected and, instead, a new PPFAC for UNS Electric should be developed, based on the PSA that Staff had recommended for APS in its recent rate case, Docket Nos. E-01345-05-0816 et al.

Q. Does UNS Electric appear to agree with that recommendation?

A. In principle, yes. UNS Electric rebuttal witness, Mr. DeConcini, has revised the Company's proposed PPFAC to contain features modeled on the PSA that Staff had recommended for APS.

Q. **Weren't there some significant differences in the PSA that Staff had recommended for APS and the PSA that the Commission ultimately adopted for APS?**

A. Yes, there were some significant differences including (1) the inclusion of a 90/10 sharing provision and (2) a 4 mill annual cap in the Commission approved APS PSA.

Q. **What reasons did the Commission state for maintaining a 90/10 sharing provision in the APS PSA?**

A. At page 111, Decision No. 69663 stated concerning the APS PSA that: "a prospective adjustor should also contain a sharing provision to provide an incentive for the Company to keep its fuel and purchased power costs as close to base rates as possible."

At pages 106-107 of Decision No. 69663, the Commission stated:

> "We believe that maintaining an incentive mechanism with the opportunity for some 'sharing' of the savings or costs of the purchased power and fuel costs is appropriate. Although the 90/10 sharing may be a 'blunt instrument,' apparently it did hit the mark and has worked to insure that APS is diligent in its fuel procurement. [cite omitted] As pointed out by RUCO, it is not a 'penalty provision' but an incentive mechanism to align APS' interest in acquiring fuel with the interests of APS' customers who pay the costs that APS incurs. However, we do agree with APS' recommendations to modify which costs are subject to the sharing requirement. We agree with APS that the fixed or demand element of long-term Purchase Power Agreements acquired through competitive procurement and renewable energy purchases not otherwise recoverable through the EPS/RES should be excluded from the sharing requirement."

Q. **Does Staff recommend a 90/10 sharing provision in the UNS Electric PPFAC?**

A. No. Staff recognizes that such sharing mechanisms can provide an incentive to utilities in procuring fuel and purchased power under the right circumstances. However, Staff believes the circumstances are somewhat different for UNS Electric than for APS, and therefore, it would be premature to include the 90/10 sharing provision that was developed for APS, in the UNS Electric PPFAC at this time.

Q. Please describe some of the differences between APS' and UNS Electric's situation for fuel and purchase power procurement that are believed to be significant with respect to whether a 90/10 sharing mechanism should be imposed.

A. APS owns a substantial and diversified mix of generation resources, including base load nuclear and coal units with relatively low and historically stable fuel costs. APS is subject to fuel cost volatility, primarily through its exposure to natural gas and purchased power price fluctuations, but not nearly to the degree that UNS Electric would be once its full requirements contract expires.

Unlike APS, which owns substantial generation, UNS Electric has been dependent upon a full requirement Purchase Power Agreement ("PPA"). When that PPA expires, UNS Electric will have to acquire power to serve its load. Because its full requirements PPA is expiring, the UNS Electric's fuel and purchase power costs after that contract expires may be significantly different than they have been while that PPA was in effect.

Thus, unlike the APS situation, which was more in the nature of a continuation of similar circumstances in terms of that utility's fuel and purchase power procurement, the UNS Electric situation represents a significant change once the full requirements PPA expires.

Moreover, there is no indication that UNS Electric would have the same degree of influence and control over its fuel and purchase power costs that APS may have over its power costs. For UNS Electric, the power cost in base rates reflects the current full requirements PPA. It is probably unrealistic in UNS Electric's situation to have an expectation that the Company would be able to keep its fuel and purchase power costs close to the power costs included in its base rates, because the power procurement situation after May 31, 2008 for this utility would be significantly different.

It is probably also unrealistic to believe that UNS Electric would anticipate a similar degree of power cost price stability than APS would have, since UNS Electric does not have the base load nuclear and coal generating units or other generating assets that APS owns. Currently, UNS Electric owns very limited generation.

Consequently, Staff believes that imposing the APS 90/10 sharing mechanism on the UNS Electric PPFAC at this time and under such circumstances would be inadvisable and unfair to UNS Electric and its ratepayers.

Q. Under what circumstances could a 90/10 sharing provision in a PPFAC be unfair to ratepayers?

A. Under circumstances where power costs have decreased due to general power market conditions, ratepayers would not receive the full amount of cost savings produced by such market-related price declines. Depriving ratepayers of the full benefit of power cost decreases that were outside of the control of the utility and occur due to general market fluctuations seems unfair and inappropriate.

Q. Are there other reasons why Staff does not favor a sharing mechanism at this time for UNS Electric's PPFAC?

A. Yes. Staff believes that an effective incentive would by definition be something that would motivate the utility to do something that it would not otherwise do, or to do something better. Staff does not believe that a 90/10 sharing provision would necessarily have that result for UNS Electric. Given UNS Electric's situation, a 90/10 sharing mechanism would not necessarily improve the utility's fuel and purchase power procurement decisions. It could even have a detrimental result on procurement decisions by emphasizing short-term price stability over long-term lowest cost procurement.

Moreover, creating a sharing provision that produces reward/penalty amounts that are not directly related to the utility's power procurement efforts does not seem appropriate. Because energy markets can be volatile and prices can change significantly, in UNS Electric's situation, sharing results could be produced through uncontrollable market fluctuations, rather than as a direct result of utility fuel procurement decisions. Even if the Company made fully prudent and well planned purchases, under a 90/10 sharing provision, the volatility of energy markets that is beyond the Company's control could cause the Company to absorb power cost increases or cause its customers to not fully receive cost decreases.

Staff is concerned that including an APS-type 90/10 sharing provision for UNS Electric's initial PPFAC would not improve upon the incentive the Company already has to procure fuel and power at a reasonable cost, and could likely result in the seemingly unfair result of the Company absorbing cost increases that are beyond its ability to control, or, conversely, preventing ratepayers from fully receiving the benefits of power cost decreases that result from energy market fluctuations, that are again, beyond the control or influence of UNS Electric.

For the reasons described above, Staff does not favor incorporating an APS-like 90/10 sharing provision into the UNS Electric PPFAC at this time.

Q. If some type of sharing provision were to be included the UNS Electric PPFAC should it apply to all fuel and purchased power costs?

A. No. As described above, Staff does not believe that a sharing provision should be included in the UNS Electric PPFAC at this time. However, if one were to be included, similar to the provisions in Decision No. 69663 for APS, it should not apply to the fixed or demand elements of long-term purchased power agreements acquired through competitive procurement or to renewable energy purchases.

Q. You have said that Staff does not favor including a sharing provision in the UNS Electric PPFAC at this time. Please explain the time element.

A. As noted above, UNS Electric's fuel and purchase power procurement situation will be significantly different for the period beyond May 31, 2008, when its full requirements PPA expires. Because of that impending change, at this time, the Company's fuel and purchased power cost history does not appear to provide a good benchmark for crafting an appropriate incentive mechanism. Moreover, as described above, the APS situation is significantly different and does not represent a good comparison with UNS Electric, since APS owns substantial and diversified generation, including base load coal and nuclear, where UNS Electric does not.

Although Staff does not recommend a sharing provision for the UNS Electric PPFAC at this time because of the unique situation that exists at this utility, it would probably be reasonable to reconsider whether an appropriate sharing mechanism could be developed and applied to the UNS Electric PPFAC after a few years of experience have occurred with the new PPFAC and the Company's procurement decisions under it. The UNS Electric circumstances at present appear to be particularly inappropriate for an APS-type 90/10 sharing mechanism. However, this does not mean that some type of sharing provision, tailored to providing an incentive toward improved fuel and purchased power procurement decisions, should never be considered for the UNS Electric PPFAC. Indeed, it might be appropriate to impose a well-conceived incentive mechanism on UNS Electric in the future after a baseline has been established with this utility's power procurement. Potentially one or two years of experience under the new PPFAC could be sufficient to provide a baseline from which appropriate power procurement incentives could be developed.

Q. You also noted that one of the differences between what Staff had recommended and what the Commission adopted for the APS PSA was a 4 mill annual cap. What did Decision No. 69663 state with respect to the 4 mill annual cap that the Commission imposed on the APS PSA?

A. Page 112 of Decision No. 69663 stated that:

> "APS proposed to modify the PSA by eliminating the four mil cumulative 'lifetime' cap on the Annual PSA Adjustor and replace it with a four mil annual cap. Staff's proposal was to eliminate the cap entirely. The Commission finds that the four mil cap should be an annual, not a lifetime cap. In other words, the PSA adjustor rate could not increase, or decrease, in any one year, more than four mills from the existing PSA adjustor rate. This level, combined with the higher base cost of fuel we are adopting in this Order, and the other changes to the PSA as described above, will significantly improve APS' cash flow, while at the same time protecting ratepayers from potential large spikes in the PSA."

Q. Please address whether a cap, such as the 4 mil annual cap, should be included in the UNS Electric PPFAC.

A. The purpose of an annual cap is to protect ratepayers from large spikes in the PPFAC. For UNS Electric, the new PPFAC would commence effective June 1, 2008. Currently, we do not have reliable information on what UNS Electric forecasts its fuel and purchase power costs to be for periods after June 1, 2008.[15] We do not know if imposing a 4 mil annual cap would prevent UNS Electric from timely recovery of its fuel and purchased power costs after June 1, 2008 and result in large deferrals. The purpose of a forward looking component in the PPFAC, as recognized by the Commission in Decision No. 69663, is to make the recovery of the utility's power costs timelier, thereby improving the Company's cash flow. An annual cap set too low could defeat that objective.

Q. Does Staff recommend an annual cap for the UNS Electric PPFAC?

A. No, not at this time. With respect to whether or not an annual cap should be imposed, I generally agree with the observations made by Mr. DeConcini on page 14, lines 16-24 of his Rebuttal Testimony:

> "It is understandable that the Commission applied a cap to APS' PSA as APS has a well-established system consisting of significant stable cost nuclear and coal facilities. UNS Electric, on the other hand, is in the process of acquiring and developing its resource requirements and it would not be appropriate to force a cap on the PPFAC rate in this period of flux. A cap could send the wrong message to over-emphasize short-term rate stability at the detriment of what is in the best long-term interest of our customers. That is, putting caps and collars for rate stability in the short-term can lead to large deferrals that can negatively impact both the Company – making it a riskier investment – and its customers – who have to pay for those cost deferrals eventually."

Consequently, Staff does not recommend imposing an annual cap on the PPFAC during what Mr. DeConcini refers to as "this period of flux."

[15] Information has been requested in Staff data requests set 20, but responses have not yet been received.

Q. Do you believe that the PPFAC proposed by Staff fairly balances the interests of the utility and its ratepayers and provides adequate incentive to the company to seek the most economical sources of fuel and purchased power?

A. Yes. Under the PPFAC proposed by Staff, UNS Electric does not receive any return on its prudently incurred fuel and purchased power costs. Staff does not believe that UNS Electric would have anything to gain by not seeking out the most economical sources of fuel and purchased power. Staff believes that its proposed PPFAC, which includes provisions for a prudence review, provides UNS Electric with adequate incentives to procure reliable sources of fuel and energy at reasonable prices, and to hedge an appropriate amount of fuel and purchased power to provide stability in price.

Q. Please discuss the inclusion of prudently incurred hedging costs in the PPFAC.

A. Page 15 of the Staff proposed Plan of Administration for the APS PSA specifies that: "Additionally, the prudent direct costs of contracts used for hedging system fuel and purchased power will be recovered under the PSA." I believe that allowing UNS Electric to recover prudent direct costs of contracts it uses for hedging system fuel and purchased power under its PPFAC would also be appropriate. UNS Electric's actual hedging costs, like its power costs, should, of course, be subject to review for prudence and reasonableness.

Q. Has UNS Electric proposed to recover broker's fees in the PFPAC?

A. Yes. At page 15 of his rebuttal testimony, Mr. DeConcini proposes to include broker's fees, as well as credit costs and legal costs, in the PFPAC.

Q. Were broker's fees allowed to be included in the APS PSA?

A. No. Decision No. 69663 states at page 107 that: "APS has not demonstrated any reason why we should change the costs that are allowed to be recovered in the adjustor, and we find that the level of broker fees that APS will collect in its base rates is reasonable. Accordingly, the broker fees in excess of the level already included in base rates will not flow through to the adjustor." Footnote 61 on page 107 of Decision No. 69663 noted that: "Staff continues to believe that broker fees are not allowable PSA costs."

Q. Since UNS Electric has not incurred the broker's fees and the types of "other costs" in the past that Mr. DeConcini seeks to include in the PFPAC, what avenue would be available to the Company to recover such future costs if they are not included in the PFPAC?

A. If the fluctuations in those costs, along with the fluctuations in all of UNS Electric's other non-PPFAC includable costs become significant, the Company could request recovery in base rates. Basically, they would be treated as any other utility operating expenses that fluctuate between rate cases.

Q. Has UNS Electric provided information on the levels of such "other costs" it is expecting?

A. No. Such information has been requested in Staff data request set 20, but responses have not yet been received.

Q. Should the PPFAC be limited to expenses that are recorded in FERC accounts 501, 547, 555 and 565 and prudent hedging costs?

A. Yes. This is consistent with Staff's recommendation for UNS Electric and consistent with the PSA for APS that was recommended by Staff, and appears to be consistent with the

PSA for APS that was approved by the Commission. The FERC Accounts 501, 547, 555 and 565 that should be included in the PPFAC for UNS Electric are basically the same accounts that the Plan of Administration included for recovery by APS under the APS PSA.[16]

Mr. DeConcini's attempt on Exhibit MJD-3, page 11, to add an additional category of "other allowable costs" for inclusion in the PPFAC, and his related proposal at page 15, lines 1-8 of his rebuttal testimony to include broker's fees, credit costs and legal fees in the PPFAC, should be rejected.

As shown on Attachment RCS-7, under item 9-B, "Other Allowable Costs," I have revised this provision of the Plan of Administration accordingly to read: "None without pre-approval from the Commission in an Order."

Q. What interest rate should be applied to the monthly PPFAC bank balance, and where is the applicable interest rate addressed in Staff's proposed Plan of Administration?

A. Staff recommends using an interest rate, based on the one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15, applied each month to the previous month's balance. This is essentially the same recommendation for the carrying cost rate that Staff proposed in the APS PSA Plan of Administration.[17] The interest rate is adjusted annually on the first business day of the calendar year in the same manner as the customer deposit rate.

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[16] Page 15 of the APS Plan of Administration listed the accounts included for the APS PSA as these four FERC accounts, and, for APS, also Account 518, Nuclear Fuel. UNS Electric does not have any nuclear generation and does not record expense in Account 518.

[17] See, e.g., Attachment RCS-4 (attached to my Direct Testimony), pages 10, 11 and 13 of the Staff Proposed Plan of Administration for APS.

Staff's proposed Plan of Administration addresses the definition of Applicable Interest on page 1, under "Definitions" to provide that Applicable Interest is "Based on on-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release H-15. The interest rate is adjusted annually on the first business day of the calendar year."

Q. How does the carrying cost rate Staff recommends compare with UNS Electric's proposed interest rate for customer deposits?

A. As shown on Exhibit TJF-1 to Direct Testimony of Thomas J. Ferry, in the red-lined version of the Rules and Regulations, page 16 of 109, section 3, UNS Electric has proposed in its rate case to use the one-year Treasury constant maturities rate for customer deposits. This is the same interest rate that Staff recommends be applied to compute carrying charges on the monthly PPFAC bank balances.

Q. Are Staff and the Company in agreement concerning the effective date for a new PPFAC mechanism for UNS Electric?

A. Yes. As stated on page 8 of Mr. DeConcini's Rebuttal Testimony, UNS Electric proposes that the new PPFAC Mechanism begin June 1, 2008 upon the expiration of the PWCC PSA.

Q. Where and how is this provided for in Staff's proposed Plan of Administration?

A. This is provided for on page 3 of Staff's proposed Plan of Administration, which states: "The PPFAC Year begins on June 1 and ends the following May 31. The first full PPFAC Year in which the PPFAC rate shall apply will begin on June 1, 2008 and end on May 31, 2009. Succeeding PPFAC Years will begin on each June 1, thereafter."

Q. Your Direct Testimony identified a number of principal features that should be considered in the design or modification of UNS Electric's PPFAC. Please describe how each of these features is covered in Staff's proposed Plan of Administration for the UNS Electric PPFAC.

A. Attachment RCS-7 to my Surrebuttal Testimony presents a redlined revision to Mr. DeConcini's Exhibit MJD-3 to reflect Staff's recommendations. The following principal features have been considered in the manner described below:

- There should be an opportunity for Commission review of proposed charges before they become applicable. Review and Commission approval modeled after the APS PSA is provided for in Staff's proposed Plan of Administration as follows. Section 5 provides for filing and procedural deadlines. Section 8 provides for compliance reporting. Section 3-A provides, in the definition of the Forward Component, that: "Should an unusual event occur causing a drastic change in forecasted fuel and energy prices – such as a hurricane or other calamity – UNSE has the discretion to apply for an adjustment to the forward component. Such an adjustment would not be implemented unless approved by the Commission." Section 5-E provides further that: "Should an unusual event occur that causes a drastic change in forecasted fuel and energy prices – such as a hurricane or other calamity – UNSE will have the ability to request an adjustment to the forward component reflecting such a change. The Commission may provide for the change over such period as the Commission determines appropriate."
- There should be a clear provision for the reconciliation of revenues and costs. Staff's proposed Plan of Administration provides for this in the filing and procedural deadlines specified in Section 5, the verification and audit provisions specified in Section 6, and the compliance reporting specified in Section 8.

- There should be an opportunity for an independent Commission review of prudence and reasonableness in all areas that drive the costs collected under the PPFAC. The content of these reviews and the issues they address should be subject to examination and comment by the affected stakeholders. The ultimate purpose of such reviews is to enable the Commission to make an informed determination of what, if any, costs resulted from ineffective or imprudent utility performance, and what, if any, adjustments should be made to future recoveries and over what periods of time. Staff's proposed Plan of Administration provides for verification and audit of the amounts charged through the PPFAC as follows: "The amounts charged through the PPFAC will be subject to periodic audit to assure their completeness and accuracy and to assure that all fuel and purchased power costs were incurred reasonably and prudently. The Commission may, after notice and opportunity for hearing, make such adjustments to existing balances or to already recovered amounts as it finds necessary to correct any accounting or calculation errors or to address any costs found to be unreasonable or imprudent. Such adjustments, with appropriate interest, shall be recovered or refunded in the True-Up Component for the following year (i.e. starting the next June 1.)" The monthly compliance reports specified in Section 8 of Staff's proposed Plan of Administration should also be helpful to the Staff, Commission and RUCO in monitoring the Company's PPFAC rate and the costs.
- The PPFAC should provide a reliable mechanism for assuring reasonably prompt recovery of prudent and reasonable fuel and energy costs. Ideally, a well designed PPFAC would avoid situations where delayed recovery of prudent and reasonable fuel and energy costs would have material financial consequences (e.g., through increased financing costs or restraints on access to financial resources). Put another way, the PPFAC should, by providing for reasonably prompt recovery of prudent and reasonable fuel and energy costs, help to maintain the utility's financial benchmarks

that promote the ability to secure financing at costs favorable to customers. Staff's Plan of Administration provides for recovery of prudent and reasonable fuel in two components, a forward component and a true-up component, as defined in Section 3, over an annual period running from June 1 through May 31 of each year, with the first full PPFAC year to begin on June 1, 2008. As explained above, Staff does not favor imposing an APS-type 90/10 sharing provision or 4-mill cap on the UNS Electric PPFAC at this time for a number of reasons, including that such provisions would be contrary to the objective of providing a reliable mechanism for assuring reasonably prompt recovery of UNS Electric's prudent and reasonable fuel and energy costs.

Q. Are there any other considerations for the PPFAC?

A. Yes. The Commission may want to include a provision designed to provide the utility with an incentive to procure fuel and purchased power at the lowest cost consistent with providing reliable electric service. Incentive provisions can be appropriate under the right circumstances. However, as described above, Staff does not recommend imposing a 90/10 sharing mechanism or a 4 mil annual cap on the UNS Electric PPFAC at this time.

Q. Are there some aspects of the detailed descriptions in Mr. DeConcini's Exhibit MJD-3, Section 7 "Calculations" that appear to be inaccurate or inconsistent with the PPFAC proposed by UNS Electric?

A. Yes. For example, Exhibit MJD-3, Section 7 "Calculations," item 2 under B on page 6, and item 2 under C on page 6, each refer to 90 percent of Off-System Sales Revenue. Page 16, lines 20-21, of Mr. DeConcini's rebuttal testimony states that: "Although UNS Electric does not anticipate substantial short-term off-system wholesale revenue, to the extent they exist, UNS Electric will credit the revenues to the PPFAC." The references to 90 percent in Exhibit MJD-3, Section 7, noted above, do not appear to be consistent with

UNS Electric's proposal to fully credit short-term off-system wholesale revenue to the PPFAC, or with the Company's recommendation that no 90/10 sharing be applied to PPFAC costs.

Q. Does Staff agree with UNS Electric that short-term off-system wholesale revenue should be credited against the PPFAC?

A. Yes. To the extent they exist, UNS Electric should be required to fully credit short-term off-system wholesale revenues to the PPFAC.

Q. Has Staff requested the Company to provide illustrative examples of the calculations that are to be filed on Schedules 1 through 5 which are listed in Section 7 of the PPFAC Plan of Administration?

A. Yes. Staff data request STF 20.3 has requested that the Company provide illustrative examples of those schedules using estimated information. Staff reserves the right to suggest modifications to such schedules or other aspects of the PPFAC after reviewing the Company's responses to outstanding discovery. Staff recommends that the specific details of the PPFAC Schedules listed in Section 7 of the Plan of Administration be developed after the parties have reviewed illustrative examples of those schedules using estimated information, such as were requested in data request STF 20.3.

Q. If the Staff-proposed PPFAC is adopted for UNS Electric, what rate impacts could this be expected to produce?

A. That is not known at this time. Staff has requested information in data request set 20 concerning the potential magnitude of the PPFAC True-Up component and details for specific cost items.

Q. Please summarize Staff's recommendations concerning the development of a new PPFAC mechanism for UNS Electric.

A. The new PPFAC for UNS Electric should be based upon the Plan of Administration detailed in Attachment RCS-7 to my Surrebuttal Testimony. This has been developed along the lines of the APS PSA Plan of Administration that Staff proposed for the APS in Docket Nos., E-01345A-05-0816 et al. For the reasons described in my testimony, Staff's proposed Plan of Administration does not include an APS-type 90/10 sharing mechanism or a 4 mill annual cap. Staff's recommended Plan of Administration removes an open-ended provision for "other includible costs" that Mr. DeConcini had included in his Exhibit MJD-3 on page 11. Staff recommends that the includable costs should be restricted to costs included in the following four FERC accounts: 501, 547, 555, and 565, plus the prudent direct costs of contracts used for hedging system fuel and purchased power costs. There should be no other costs included in the new PPFAC. The new PPFAC for UNS Electric should become effective June 1, 2008, upon expiration of the Company's all requirements power contract with PWCC.

VII. COMPANY'S PROPOSED RATEMAKING TREATMENT FOR A NEW PEAKING UNIT, BLACK MOUNTAIN GENERATING STATION

Q. As a result of the UNS Electric rebuttal, has the Staff revised its opposition to including the Black Mountain Generating Station ("BMGS") in rate base in the current UNS Electric rate case?

A. No. Staff continues to believe that inclusion of BMGS in rate base in the current rate case would be premature and inadvisable for several reasons.

Q. What is the BMGS, and what ratemaking treatment is the Company requesting for it in the current rate case?

A. The BMGS is a 90 MW peaking facility under development at a site in Mohave County. BMGS consists of two LM 6000 combustion turbines. It is being developed by an affiliated company, UniSource Energy Development Company ("UEDC"). UNS Electric witness Kevin Larson states (at pages 2 and 4 of his Direct Testimony) that UEDC has negotiated a turnkey construction contract for the project totaling $46 million. UEDC is in the process of obtaining permits and making other arrangements to meet a projected operating date of May 2008. The Company estimates additional costs of permitting, site improvements, obtaining water supply, connecting to a gas pipeline, making substation improvements, providing project supervision and paying interest on borrowed funds of $14 million to $19 million. In total, UNS Electric estimates BMGS will cost $60 to $65 million.

The Company's Rebuttal Testimony appears to represent no change in position to UNS Electric's original proposal related to BMGS. UNS Electric requests that the Commission include the BMGS in its rate base effective as of June 1, 2008 as set forth in the testimony of Company witness Kevin Larson. As explained on page 3 of Mr. Larson's Direct Testimony: "the Company is requesting a post-test year adjustment to rate base and a corresponding reclassification of rates effective June 1, 2008, or at a later date if commercial operation is delayed beyond June 1, 2008." The Company's proposed post-test year adjustment would add approximately $10 million to the non-fuel (base rate) revenue requirement, assuming a $60 million completion cost. As Mr. Larson further explained (on page 3 of his Direct Testimony): "On the effective date of this adjustment, UNS Electric would increase the average base delivery charge to customers by approximately 0.6 cents per kWh, and make a corresponding decrease of 0.6 cents per kWh to the base power supply rate." He states that, initially, this proposal will be "revenue neutral" to UNS Electric. Other features of the Company's proposed ratemaking treatment for BMGS include (per Mr. Larson's Direct Testimony, at page 4):

- If actual project costs exceed $60 million, UNS Electric will not seek rate base treatment of any cost difference until the Company's next rate case.
- Following the purchase of the project by UNS Electric and upon commercial operation of the facility, the Company would provide the Commission with a project completion report, detailing the cost of completion and the results of pre-commercial testing.
- Thirty days after such report is filed, or on June 1, 2008 if the project is completed prior to May 1, 2008, the Company would implement the rate reclassification described above.

Q. What has the Company said it would do if the Commission rejects its proposal for a post-test year adjustment to rate base?

A. At page 5 of his Direct Testimony, Mr. Larson states that UNS Electric could elect to enter into a purchased power agreement ("PPA") with its affiliate, UEDC. He states that the terms of the PPA would be subject to approval by the Commission and by FERC. Bypassing these approvals is not necessarily a good idea. Approval of PPAs with affiliated parties is intended to provide a safeguard for ratepayers to prevent abuses.

Q. Does Staff support the Company's requested ratemaking treatment for BMGS in the current rate case?

A. No. For several reasons, Staff views the Company's requested ratemaking treatment for this plant is premature and inappropriate in the current rate case.

Q. Please summarize why Staff recommends that BMGS not be added to rate base in the current UNS Electric rate case.

A. There are several concerns with approving rate base treatment of BMGS in the current rate case, including the uncertainties relating to the plant. One of the primary deficiencies is that the plant is not expected to be in commercial operation until May or June of 2008. This is well beyond the end of the test year in the current UNS Electric rate case, and is several months beyond even the scheduled hearing. Consequently, this plant addition does not qualify as a pro forma adjustment to plant in service.

In the current UNS Electric rate case, BMGS would not qualify for an exception to the inclusion of CWIP in rate base because only minimal, if any, costs have been incurred by UNS Electric in the test year. As of the end of the test year, it appears the Company had not incurred any cost for BMGS construction. The response to STF 11.2 states that none of the Company's end-of-test-year CWIP balance includes BMGS cost. Additionally, Staff's engineering report, which reported on the results of a site visit made in June 2007 among other things, revealed very little work has apparently been done at the plant site. It appears that costs related to BMGS construction are being recorded on the books of the affiliate, UEDC, rather than on UNS Electric's books.

Additionally, there is uncertainty regarding the total cost of the plant. There is uncertainty regarding whether the ownership of the plant would be at the utility, UNS Electric, or with the affiliate, UEDC. There is uncertainty regarding whether it would be more economical for UNS Electric and its ratepayers for the utility to own the plant or to obtain power by some other means. Given the substantial uncertainties regarding BMGS, Staff believes it would be premature and inappropriate to approve the Company's request for rate base inclusion.

Staff recognizes that there can be benefits to a utility owning its own generation. However, it is not known whether having UNS Electric purchase a peaking unit such as BMGS is the most economical alternative to obtain power for the short, intermediate or long-term.

In terms of the impact on cash flow, the Company's proposal is to have BMGS included in rate base by a "revenue neutral" rate reclassification that apparently would not result in any net rate adjustment. It is unclear how the Company's proposed "revenue neutral" rate reclassification would result in a substantial improvement in the Company's cash flow if it were to be implemented in a truly "revenue neutral" manner that did not result in a substantial net rate increase. It is unclear whether UNS Electric ownership of BMGS would reduce purchased power and fuel costs by $10 million per year. Thus, what UNS Electric has proposed as being initially "revenue neutral" may end up producing large customer rate increases that have not been estimated with accuracy at this time. Staff has issued a set of data requests (set 20) which attempted to elicit additional information on the potential rate impacts on UNS Electric customers with BMGS ownership versus other alternatives. As of the date of this writing (August 23, 2007) responses had not yet been received.

In conclusion, the Company's requested rate base inclusion of BMGS in the current case is premature and would bypass too many regulatory safeguards. The Company's proposed rate base inclusion of BMGS in the current case should be rejected. Staff believes that the ratemaking treatment of BMGS would most appropriately be addressed in the context of UNS Electric's next rate case.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

Attachment RCS-6

Staff Revised Accounting Schedules

Accompanying the Surrebuttal Testimony of Ralph C. Smith

Schedule	Description	Pages	Note
	Revenue Requirement Summary Schedules		
A	Calculation of Revenue Deficiency (Sufficiency)	1	Revised
A-1	Gross Revenue Conversion Factor	1	Revised
B	Adjusted Rate Base	1	Revised
B.1	Summary of Adjustments to Rate Base	1	Revised
C	Adjusted Net Operating Income	1	Revised
C.1	Summary of Net Operating Income Adjustments	4	Revised
D	Capital Structure and Cost Rates	1	Revised
	Rate Base Adjustments		
B-1	Remove Construction Work in Progress	1	
B-2	Adjust CWIP for Plant in Service by End of Test Year	1	
B-3	Plant in Service Addition Subject to Reimbursement	1	Revised
B-4	Cash Working Capital - Lead/Lag Study	1	
B-5	Accumulated Deferred Income Taxes	1	
	Net Operating Income Adjustments		
C-1	Revenue Adjustment for CARES Discount	1	
C-2	Remove Depreciation & Property Taxes for CWIP	1	
C-3	Depreciation & Property Taxes for CWIP Found to be In-Service in the Test Year	1	
C-4	Fleet Fuel Expense	2	Revised
C-5	Postage Expense	1	
C-6	Normalize Injuries and Damages Expense	1	
C-7	Incentive Compensation Expense	1	
C-8	Supplemental Executive Retirement Plant (SERP) Expense	1	
C-9	Stock Based Compensation Expense	1	
C-10	Property Tax Expense	1	
C-11	Rate Case Expense	1	
C-12	Edison Electric Institute Dues	2	
C-13	Other Membership and Industry Association Dues	1	
C-14	Interest Synchronization	1	Revised
C-15	Depreciation Rates Correction	4	
C-15.1	Depreciation Rates Correction - Details of Company's Pre-Correction Calculation		[RCS-2]
C-15.2	Depreciation Rates Correction - Details of Calculation Using Corrected Rates		[RCS-2]
C-16	Emergency Bill Assistance Expense	1	
C-17	Markup Above Cost in Charges from Affiliate, Southwest Energy Services	1	Added
C-18	Bad Debt Expense	1	Added
C-19	Remove Double Count from Outside Services-Demand Side Management	1	Added
C-20	Correct Year-End Accrual Expense Amount for Out-of-Period Expense	1	Added
	Total Pages, Including Content Listing	41	

[RCS-2] Depreciation Rates Correction Support was filed in Attachment RCS-2 with Mr. Smith's direct testimony.
That additional supporting detail has not changed, and is therefore not being re-filed with Mr. Smith's surrebuttal.

UNS Electric Inc.
Computation of Increase in Gross Revenue Requirement

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule A Revised
Page 1 of 1

Line No.	Description	Reference	UNS Proposed Original Cost (A)	UNS Proposed Fair Value (B)	Staff Proposed Original Cost (C)	Staff Proposed Fair Value (D)
1	Adjusted Rate Base	Sch. B	$ 140,991,324	$ 177,802,341	$ 130,707,320	$ 167,518,337
2	Rate of Return	Sch. D	9.89%	7.84%	8.99%	7.02%
3	Operating Income Required		$ 13,946,320	$ 13,946,320	$ 11,746,759	$ 11,759,787
4	Net Operating Income Available	Sch. C	$ 8,742,011	$ 8,742,011	$ 9,515,701	$ 9,515,701
5	Operating Income Excess/Deficiency		$ 5,204,309	$ 5,204,309	$ 2,231,058	$ 2,244,086
6	Gross Revenue Conversion Factor	Sch. A-1	1.6346	1.6346	1.634626	1.634626
7	Overall Revenue Requirement		$ 8,507,097	$ 8,507,097	$ 3,646,946	$ 3,668,242

Notes and Source
Cols. A & B taken from UNS Electric, Inc. filing, Schedule A-1

UNS Electric, Inc.
Computation of Gross Revenue Conversion Factor

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule A-1 Revised
Page 1 of 1

Line No.	Description	Company Proposed (A)	Staff Proposed (B)
1	Gross Revenue	100.00%	100.00000%
2	Less: Uncollectible Revenue	0.36792%	0.36792%
3	Taxable Income as a Percent	99.63%	99.63208%
4	Less: Federal and State Income Taxes	38.46%	38.46%
5	Change in Net Operating Income	61.18%	61.17609%
6	Gross Revenue Conversion Factor	1.6346	1.634626

Notes and Source
Col.A: UNS Electric Inc. Filing, Schedule C-3
Col.B:

Components of Revenue Requirement Increase (Revised)

	Amount	Percent
Net Income	$ 2,231,059	61.18%
Federal and State Income Taxes	$ 1,402,469	38.46%
Uncollectibles	$ 13,418	0.37%
Total Revenue Increase	$ 3,646,946	100.00%

UNS Electric, Inc.
Original Cost and RCND Adjusted Rate Base

Test Year Ended June 30, 2006

Line No.	Description	Original Cost As Adjusted by UNS (A)	Original Cost Staff Adjustments (B)	Original Cost As Adjusted by Staff (C)	RCND As Adjusted by UNS (D)	RCND Staff Adjustments (E)	RCND As Adjusted by Staff (F)
1	Gross Utility Plant in Service	$ 390,513,651	$ (10,318,899)	$ 380,194,752	$ 612,326,062	$ (10,318,899)	$ 602,007,163
2	Less: Accumulated Depreciation	$ (159,524,693)	$ -	$ (159,524,693)	$ (257,585,628)	$ -	$ (257,585,628)
3	Net Utility Plant in Service	$ 230,988,958	$ (10,318,899)	$ 220,670,059	$ 354,740,434	$ (10,318,899)	$ 344,421,535
4	Citizens Acquisition Discount	$ (93,273,341)	$ -	$ (93,273,341)	$ (150,061,415)	$ -	$ (150,061,415)
5	Less: Accum. Amort. - Citizens Acq. Discount	$ (11,224,066)	$ -	$ (11,224,066)	$ (18,123,969)	$ -	$ (18,123,969)
6	Net Citizens Acquisition Discount	$ (82,049,275)	$ -	$ (82,049,275)	$ (131,937,446)	$ -	$ (131,937,446)
7	Total Net Utility Plant	$ 148,939,683	$ (10,318,899)	$ 138,620,784	$ 222,802,988	$ (10,318,899)	$ 212,484,089
8	Customer Advances for Construction	$ (8,692,444)	$ -	$ (8,692,444)	$ (9,559,141)	$ -	$ (9,559,141)
							$ -
9	Customer Deposits	$ (3,778,419)	$ -	$ (3,778,419)	$ (3,778,419)	$ -	$ (3,778,419)
							$ -
10	Accumulated Deferred Income Taxes	$ 1,154,833	$ (161,555)	$ 993,278	$ 1,780,258	$ (161,555)	$ 1,618,703
11	Total Deductions	$ (11,316,030)	$ (161,555)	$ (11,477,585)	$ (11,557,302)	$ (161,555)	$ (11,718,857)
12	Allowance for Working Capital	$ 3,367,671	$ 196,450	$ 3,564,121	$ 3,367,671	$ 196,450	$ 3,564,121
							$ -
13	Regulatory Assets	$ -	$ -	$ -	$ -	$ -	$ -
							$ -
14	Regulatory Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
15	Total Rate Base	$ 140,991,324	$ (10,284,004)	$ 130,707,320	$ 214,613,357	$ (10,284,004)	$ 204,329,353

Notes and Source
Cols. A and D: UNS Electric Inc. filing, Schedule B

Fair Value Calculation (Per Company)

Original Cost	$ 140,991,324	
RCND	$ 214,613,357	
Total	$ 355,604,681	
Average (Fair Value)	$ 177,802,341	See Sch. A

Fair Value Calculation (Per Staff)

Original Cost	$ 130,707,320	
RCND	$ 204,329,353	
Total	$ 335,036,673	
Average (Fair Value)	$ 167,518,337	See Sch. A

UNS Electric, Inc.
Summary of Rate Base Adjustments

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule B.1 Revised
Page 1 of 1

Line No.	Description	Staff Adjustments	CWIP	Rhode Homes Line Extensions	Customer Advances for Construction	Cash Working Capital	ADIT	N/A
			B-1	B-2	B-3 Revised	B-4 Revised	B-5	B-6
1	Gross Utility Plant in Service	$ (10,318,899)	$ (10,761,154)	$ 442,255				
2	Less: Accumulated Depreciation	$ -						
3	Net Utility Plant in Service	$ (10,318,899)	$ (10,761,154)	$ 442,255	$ -	$ -	$ -	$ -
4	Citizens Acquisition Discount	$ -						
5	Less: Accum. Amort. - Citizens Acq. Discount	$ -						
6	Net Citizens Acquisition Discount	$ -						
7	Total Net Utility Plant	$ (10,318,899)	$ (10,761,154)	$ 442,255	$ -	$ -	$ -	$ -
8	Customer Advances for Construction	$ -		$ -				
9	Customer Deposits	$ -						
10	Accumulated Deferred Income Taxes	$ (161,555)					$ (161,555)	
11	Total Deductions	$ (161,555)	$ -	$ -	$ -	$ -	$ (161,555)	$ -
12	Allowance for Working Capital	$ 196,450				$ 196,450		
13	Regulatory Assets	$ -						
14	Regulatory Liabilities	$ -						
15	Total Rate Base	$ (10,284,004)	$ (10,761,154)	$ 442,255	$ -	$ 196,450	$ (161,555)	$ -

UNS Electric, Inc.
Adjusted Net Operating Income

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C Revised
Page 1 of 1

Line No.	Description	As Adjusted by UNS (A)	Staff Adjustments (B)	As Adjusted by Staff (C)
	Operating Revenues			
1	Electric Retail Revenues	$ 156,651,860	$ 52,937	$ 156,704,797
2	Sales for Resale	$ 246,016	$ -	$ 246,016
3	Other Operating Revenues	$ 1,589,014	$ -	$ 1,589,014
4	Total Operating Revenues	$ 158,486,890	$ 52,937	$ 158,539,827
	Operating Expenses			
5	Purchased Power	$ 106,224,185	$ -	$ 106,224,185
6	Other O&M Expenses	$ 26,423,248	$ (709,028)	$ 25,714,220
7	Depreciation & Amortization	$ 11,812,574	$ (494,656)	$ 11,317,918
8	Taxes Other Than Income Taxes	$ 3,447,533	$ (292,679)	$ 3,154,854
9	Income Taxes	$ 1,837,339	$ 775,610	$ 2,612,949
10	Total Operating Expenses	$ 149,744,879	$ (720,753)	$ 149,024,126
11	Net Operating Income	$ 8,742,011	$ 773,690	$ 9,515,701

Notes and Source
Col. A: UNS Electric, Inc. filing, Schedule C-1
Col. B: Staff Schedule C.1

UNS Electric, Inc.
Summary of Net Operating Income Adjustments

Test Year Ended June 30, 2006

Line No.	Description	Stafff Adjustments	CARES Discount C-1	Remove Depreciation & Property Taxes for CWIP C-2	Depreciation & Property Taxes for CWIP Found in Service C-3	Fleet Fuel Expense C-4 Revised	Postage Expense C-5
	Operating Revenues						
1	Electric Retail Revenues	$ 52,937	$ 52,937				
2	Sales for Resale	$ -					
3	Other Operating Revenues	$ -					
4	Total Operating Revenues	$ 52,937	$ 52,937	$ -	$ -	$ -	$ -
	Operating Expenses						
5	Purchased Power	$ -					
6	Other O&M Expenses	$ (709,028)				$ (62,197)	$ 17,503
7	Depreciation & Amortization	$ (494,656)		$ (449,816)	$ 18,265		
8	Taxes Other Than Income Taxes	$ (292,679)		$ (239,696)	$ 8,317		
9	PRE-TAX OPERATING EXPENSES	$ (1,496,363)	$ -	$ (689,512)	$ 26,582	$ (62,197)	$ 17,503
10	PRE-TAX OPERATING INCOME	$ 1,549,300	$ 52,937	$ 689,512	$ (26,582)	$ 62,197	$ (17,503)
11	Income Taxes	$ 775,610	$ 20,433	$ 266,138	$ (10,260)	$ 24,007	$ (6,756)
12	TOTAL OPERATING EXPENSES	$ (720,753)	$ 20,433	$ (423,374)	$ 16,322	$ (38,190)	$ 10,747
13	OPERATING INCOME	$ 759,377	$ 32,504	$ 423,374	$ (16,322)	$ 38,190	$ (10,747)

Notes and Source

Combined Effective Tax Rate* 38.598%

* Per UNS Electric filing, Schedule C-3

UNS Electric, Inc.
Summary of Net Operating Income Adjustments

Test Year Ended June 30, 2006

Line No.	Description	Injuries and Damages Expense	Incentive Compensation Expense	SERP Expense	Stock Based Compensation Expense	Property Tax Expense	Rate Case Expense
		C-6	C-7	C-8	C-9	C-10	C-11
	Operating Revenues						
1	Electric Retail Revenues						
2	Sales for Resale						
3	Other Operating Revenues						
4	Total Operating Revenues	$ -	$ -	$ -	$ -	$ -	$ -
	Operating Expenses						
5	Purchased Power						
6	Other O&M Expenses	$ (159,063)	$ (42,448)	$ (83,506)	$ (82,873)		$ (111,667)
7	Depreciation & Amortization						
8	Taxes Other Than Income Taxes		$ (1,553)			$ (59,747)	
9	PRE-TAX OPERATING EXPENSES	$ (159,063)	$ (44,001)	$ (83,506)	$ (82,873)	$ (59,747)	$ (111,667)
10	PRE-TAX OPERATING INCOME	$ 159,063	$ 44,001	$ 83,506	$ 82,873	$ 59,747	$ 111,667
11	Income Taxes	$ 61,395	$ 16,984	$ 32,232	$ 31,987	$ 23,061	$ 43,101
12	TOTAL OPERATING EXPENSES	$ (97,668)	$ (27,017)	$ (51,274)	$ (50,886)	$ (36,686)	$ (68,566)
13	OPERATING INCOME	$ 97,668	$ 27,017	$ 51,274	$ 50,886	$ 36,686	$ 68,566

Notes and Source

Combined Effective Tax Rate* 38.598%

* Per UNS Electric filing, Schedule C-3

UNS Electric, Inc.
Summary of Net Operating Income Adjustments

Test Year Ended June 30, 2006

Line No.	Description	Edison Electric Institute Dues	Other Membership Dues	Interest Synchro-nization	Depreciation Rates Correction	Emergency Bill Assistance	SES Markup Above Cost
		C-12	C-13	C-14 Revised	C-15	C-16	C-17 Added
	Operating Revenues						
1	Electric Retail Revenues						
2	Sales for Resale						
3	Other Operating Revenues						
4	Total Operating Revenues	$ -	$ -	$ -	$ -	$ -	$ -
	Operating Expenses						
5	Purchased Power						
6	Other O&M Expenses	$ (8,470)	$ (6,482)			$ 20,000	$ (10,906)
7	Depreciation & Amortization				$ (63,105)		
8	Taxes Other Than Income Taxes						
9	PRE-TAX OPERATING EXPENSES	$ (8,470)	$ (6,482)	$ -	$ (63,105)	$ 20,000	$ (10,906)
10	PRE-TAX OPERATING INCOME	$ 8,470	$ 6,482	$ -	$ 63,105	$ (20,000)	$ 10,906
11	Income Taxes	$ 3,269	$ 2,502	$ 177,611	$ 24,357	$ (7,720)	$ 4,209
12	TOTAL OPERATING EXPENSES	$ (5,201)	$ (3,980)	$ 177,611	$ (38,748)	$ 12,280	$ (6,697)
13	OPERATING INCOME	$ 5,201	$ 3,980	$ (177,611)	$ 38,748	$ (12,280)	$ 6,697

Notes and Source

Combined Effective Tax Rate*	38.598%

* Per UNS Electric filing, Schedule C-3

UNS Electric, Inc.
Summary of Net Operating Income Adjustments

Test Year Ended June 30, 2006

Line No.	Description	Bad Debt Expense C-18 Added	Outside Services-DSM C-19 Added	Correct Year-End Accrual Expense C-20 Added
	Operating Revenues			
1	Electric Retail Revenues			
2	Sales for Resale			
3	Other Operating Revenues			
4	Total Operating Revenues	$ -	$ -	$ -
	Operating Expenses			
5	Purchased Power			
6	Other O&M Expenses	$ (155,609)	$ (17,055)	$ (6,256)
7	Depreciation & Amortization			
8	Taxes Other Than Income Taxes			
9	PRE-TAX OPERATING EXPENSES	$ (155,609)	$ (17,055)	$ (6,256)
10	PRE-TAX OPERATING INCOME	$ 155,609	$ 17,055	$ 6,256
11	Income Taxes	$ 60,062	$ 6,583	$ 2,415
12	TOTAL OPERATING EXPENSES	$ (95,547)	$ (10,472)	$ (3,841)
13	OPERATING INCOME	$ 95,547	$ 10,472	$ 3,841

Notes and Source
Combined Effective Tax Rate* 38.598%
* Per UNS Electric filing, Schedule C-3

UNS Electric, Inc.
Capital Structure & Cost Rates

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule D

Line No.	Capital Source	Capitalization Amount	Capitalization Percent	Cost Rate	Weighted Avg. Cost of Capital
	UNS - Proposed				
1	Short-Term Debt	$ 5,000	3.97%	6.36%	0.25%
2	Long-Term Debt	$ 59,486	47.18%	8.22%	3.88%
3	Common Stock Equity	$ 61,587	48.85%	11.79%	5.76%
4	Total Capital	$ 126,073	100.00%		9.89%
	ACC Staff - Proposed				
5	Short-Term Debt	$ 5,000	3.96%	6.36%	0.25%
6	Long-Term Debt	$ 59,545	47.21%	8.16%	3.85%
7	Common Stock Equity	$ 61,587	48.83%	10.000%	4.88%
8	Total Capital	$ 126,132	100.00%		8.99%
9	Difference				-0.90%
10	Weighted Cost of Debt				4.10%
	ACC Staff - Proposed Cost of Capital for Fair Value Rate Base				
11	Short-Term Debt	$ 5,181,370	3.09%	6.36%	0.20%
12	Long-Term Debt	$ 61,704,939	36.83%	8.16%	3.01%
13	Common Stock Equity	$ 63,821,011	38.10%	10.000%	3.81%
	Capital financing OCRB	$ 130,707,321			
14	Appreciation above OCRB not recognized on utility's books	$ 36,811,017	21.98%	0% [a]	0.00%
15	Total capital supporting FVRB	$ 167,518,338	100.00%		7.02%

Notes and Source

Lines 11-15, Col.A:

Fair Value Rate Base	$ 167,518,337	Schedule A
Original Cost Rate Base	$ 130,707,320	Schedule A
Difference	$ 36,811,017	

Difference is appreciation of Fair Value over Original Cost that is not recognized on the utility's books.

[a] The appreciation of Fair Value over Original Cost has not been recognized on the utility's books. Such off-book appreciation has not been financed by debt or equity capital recorded on the utility's books. The appreciation over Original Cost book value is therefore recognized for cost of capital purposes at zero cost.

UNS Electric, Inc.
Remove Construction Work in Progress

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Remove Construction Work in Progress	$ (10,761,154)	A & B

Notes and Source

A: UNS Electric Filing, Schedule B-2, page 2, line 1
B: Testimony of Staff witness Ralph Smith

UNS Electric, Inc.
Adjust CWIP for Plant in Service by End of Test Year

Test Year Ended June 30, 2006

Line No.	Description	Plant Account	Amount	Reference
1	Adjustment to Plant in Service for Rhode Homes Line Extensions	365	$ 442,255	A
2	Adjustment to Customer Advances for Construction			A
3	Net Rate Base Adjustment		$ 442,255	

Notes and Source

A: Staff memorandum concerning its Preliminary Field Assessment of Used and Useful Review for UNS Electric as it relates to the Rhode Homes overhead line extensions

Line 2: Letter of Agreement dated March 2, 2006 indicates the customer will pay to the Company a total Customer Advance of $360,117
The Company's response to data request STF 15.4(f) and (g) indicate that, as of June 30, 2006, UNS Electric had received Customer Advances totaling $360,117 for this project, and no additional Customer Advances for this project have been received subsequent to June 30, 2006.

UNS Electric, Inc.
Plant in Service Addition Subject to Reimbursement

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Adjustment to Contributions in Aid of Construction Decrease to Plant in Service	$ (236,874)	Notes A & B
		Withdrawn, subject to obtaining supporting documentation	

Notes and Source

A: Staff memorandum concerning its Preliminary Field Assessment of Used and Useful Review for UNS Electric as it relates to the Tubac Golf Resort Overhead to Underground Conversion

The Company's response to STF 15.4(d) states that: "this customer requested work was paid 100% by the customer as a Contribution in Aid of Construction."

B Adjustment withdrawn based on explanation in UNS Electric witness Karen Kissinger's rebuttal testimony at pages 4-5 subject to obtaining adequate supporting documentation, which was requested in data request STF 20.50

UNS Electric, Inc.
Cash Working Capital - Lead/Lag Study
For the Test Year Ending 6/30/06

Line No.	Description (A)	FERC	Per UNS Electric Pro Forma Test Year Amount (A)		Staff Adjustments (B) Revised	Staff Adjusted (C) Revised	Expense Lag Days (D)		Net Lag Days (RevLag - Col. D) (E)	Lead/Lag Factor (Col. E/365) (F)	Cash Working Capital Required (Col. F X Col.C) (G) Revised
	Operating Expenses:										
	Non-Cash Expenses -										
1	Bad Debts Expense	904	$ 579,538	1a	(155,609)	423,929					$ -
2	Depreciation	403/404	15,594,232	1.2a	(494,656)	15,099,576					-
3	Amortization	406	(3,781,658)	1.2b	-	(3,781,658)					-
4	Deferred Income Taxes		494,521	1.3a		494,521					-
	Other Operating Expenses -										
5	Salaries and Wages (UNSE Direct Employees)	Multi	4,571,466	2.2a		4,571,466	23.33	D.	12.26	0.0336	153,601
6	Incentive Pay (UNSE Direct Employees)	Multi	98,247	3a	(17,962)	80,285	267.00	D.	(231.41)	(0.6340)	(50,901)
7	Purchased Power		106,021,950	1b		106,021,950	33.79	E.	1.80	0.0049	519,508
8	Transmission Other		7,009,878	1c		7,009,878	40.67	F.	(5.08)	(0.0139)	(97,437)
9	Meter Reading		730,556	1d		730,556	33.67	G.	1.92	0.0053	3,872
10	Customer Records & Collection Expenses (excluding alloc.)	903	2,982,604	1e-4b	-	2,982,604	34.94	H.	0.65	0.0018	5,369
11	Office Supplies and Expenses	921	535,854	1.1a		535,854	50.89	I.	(15.30)	(0.0419)	(22,452)
12	Injuries and Damages	925	512,417	1.1b	(159,063)	353,354	70.52	J.	(34.93)	(0.0957)	(33,816)
13	Pension & Benefits	926	1,172,133	1.1c	-	1,172,133	51.37	K	(15.78)	(0.0432)	(50,636)
14	Support Services (Direct Labor, Burdens, System Allocation)		5,631,155	4a	(190,865)	5,440,290	44.77	L.	(9.18)	(0.0252)	(137,095)
15	Property Taxes	408	3,096,371	1.3b	(291,126)	2,805,245	213.00	M.	(177.41)	(0.4861)	(1,363,630)
16	Payroll Taxes	408	348,088	1.3c	(1,553)	346,535	19.87	M.	15.72	0.0431	14,936
17	Current Income Taxes		1,342,818	1.3d		3,520,897	41.42	M.	(5.83)	(0.0160)	(56,334)
18	Interest on Customer Deposits	431	217,492	1.3e		217,492	182.50	Q.	(146.91)	(0.4025)	(87,541)
19	Other Operations and Maintenance	Multi	2,587,216	X	(185,529)	2,401,687	41.21	N.	(5.62)	(0.0154)	(36,986)
20	Total Operating Expenses		149,744,878		(1,496,363)	150,426,594					
	Other Cash Working Capital Elements:										
21	Interest on Long-Term Debt		5,819,157	8a	(460,157)	5,359,000	90.22	O.	(54.63)	(0.1497)	(802,242)
22	Revenue Taxes and Assessments	Calc	$ 13,983,561	P.	329,752	14,313,313	45.71	M.	(10.12)	(0.0277)	(396,479)
23	Total Cash Working Capital - Calculated										$ (2,438,263)
24	Total Cash Working Capital - Per UNS Electric Filing, Schedule B-5, page 3 of 3										(2,634,713)
25	Adjustment to Cash Working Capital										196,450

Notes and Source
UNS Electric filing, Schedule B-5, page 3 of 3
RUCO 1.10 2005 UNSE Lead-Lag Summary.xls
Revenue Lag, in days 35.59
Col.B: Staff workpapers for CWC calculation

Line 17, Col.C, Current income taxes:

26	Per UNS Electric, Current Income Taxes	$ 1,342,818	Col.A, line 17
27	Staff adjustments to Current Income Taxes	$ 775,610	Schedule C.1
28	Staff adjusted Current Income Taxes before Revenue Increase	$ 2,118,428	Schedule C
29	Income taxes for revenue increase	$ 1,402,469	Schedule A-1
30	Total current income taxes for CWC calculation	$ 3,520,897	

2,612,949	-	$ 2,118,428	=	$ 494,521
Total Income Taxes		Current Inc Taxes		Deferred Inc Taxes
Schedule C		Line 28		Col. A, Line 4

Line 22, Revenue Based Taxes

31	Revenue adjustments	$ 52,937	Schedule C
32	Staff recommended rate increase	$ 3,646,946	Schedule A, filtered through CWC macro
33	Revenue adjustments	$ 3,699,883	
34	Revenue based taxes	0.0891249	B-4 W/P 2
35	Adjustment to revenue based taxes	$ 329,752	

UNS Electric, Inc.
Accumulated Deferred Income Taxes

Test Year Ended June 30, 2006

Line No.	Description	Account	Amount	Reference
1	SERP	190	$ (97,217)	A
2	Stock Based Compensation	190	$ (64,338)	A
3	Total Adjustment to ADIT		$ (161,555)	

Notes and Source

A: Staff has removed SERP and Restricted Stock from operating expenses and allocated incentive compensation expense 50/50 to shareholders and ratepayers. This adjustment coordinates the corresponding ADIT amounts with those recommendations.

	Account and Description	Per Books (1)	UNS Electric Adjustment (2)	UNS Electric Adjusted		Staff Adjustment
	Account 190					
4	SERP	$ 99,736	$ (2,519)	$ 97,217	a	$ (97,217)
5	Restricted Stock	$ 28,728	$ (1,970)	$ 26,758	b	$ (26,758)
6	Dividend Equivalents	$ 37,661	$ (1,844)	$ 35,817	c	$ (35,817)
7	Stock Options	$ -	$ 1,763	$ 1,763	d	$ (1,763)
8	Stock Based Compensation related ADIT	$ 66,389	$ (2,051)	$ 64,338		$ (64,338)

(1) Response to STF 3.60
(2) UNS Electric ADIT workpapers
a: UNS Electric workpaper "Pro Forma ADIT - Account 190" "SERP 12G"
b: UNS Electric workpaper "Pro Forma ADIT - Account 190" "Restricted Stock 12F"
c: UNS Electric workpaper "Pro Forma ADIT - Account 190" "Dividend Equivalents 12C"
d: UNS Electric workpaper "Pro Forma ADIT - Account 190" "Stock Options 12H"

UNS Electric, Inc.
Revenue Adjustment for CARES Discount

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Remove Company Revenue Adjustment for Company's Proposed Revisions to CARES Discounts	$ 52,937	A&B

Notes and Source
A: UNS Electric Filing, Schedule C-2, page 1, line 1
B: Testimony of Staff witness Julie McNeely-Kirwan

UNS Electric, Inc.
Remove Depreciation & Property Taxes for CWIP

Docket No. E-04204A-06-0783
Schedule C-2

Test Year Ended June 30, 2006

Line No.	Description	Account	Amount	Reference
1	CWIP Related Depreciation Expense	403	$ (449,816)	A
2	CWIP Related Property Tax Expense	408	$ (239,696)	A
3	Total Adjustments		$ (689,512)	

Notes and Source

A: UNS Electric Filing, Schedule C-2, page 4, lines 7 and 8

UNS Electric, Inc.
Depreciation & Property Taxes for CWIP Found to be In-Service in the Test Year

Test Year Ended June 30, 2006

Line No.	Description	Account	Amount	Reference
1	Rhode Homes Related Depreciation Expense	403	$ 18,265	A
2	Rhode Homes Related Property Tax Expense	408	$ 8,317	B
3	Total Adjustments		$ 26,582	

A: Depreciation Rate taken from Attachment REW-2, Statement A, from Dr. White's testimony

Line No.	Description	Plant Account	Amount	Depreciation Rate	Depreciation Expense
4	Rhode Homes Overhead Line Extensions (see Sch. B-2)	365	$ 442,255	4.13%	$ 18,265

B: **Calculation of Property Tax Expense**

Line No.	Description	Amount	
5	Rhode Homes Overhead Line Extensions	$ 442,255	
6	Less: Accumulated Depreciation	$ (18,265)	
7	Subtotal	$ 423,990	
8	Assessment Ratio	23.5%	
9	Taxable Value	$ 99,638	
10	Mohave Property Tax Rate	8.3471%	per Company's Property Tax adjustment workpaper
11	Property Tax Expense	$ 8,317	

UNS Electric, Inc.
Fleet Fuel Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-4 (Revised)

Line No.	Description	Amount	Reference
1	UNS Electric Adjustment to Fleet Fuel Expense	$ 73,661	A
2	Staff Recommended Pro Forma Adjustment to Fleet Fuel Expense	$ 11,464	B
3	Adjustment to Fleet Fuel Expense	$ (62,197)	L2 - L1

Notes and Source

A: UNS Electric Filing, Schedule C-2, page 3, lines 5 and 6

B: Per Company's workpapers showing calculation of Fleet Fuel Expense adjustment UNSE(0783)10597:
(Dallas Dukes' rebuttal workpapers for fleet fuel expense)
Actual fleet fuel expense invoices for July 2006 through June 2007

4	Gallons purchased	207,310	UNSE(0783)10597
5	Weighted average price per gallon	$ 2.82	UNSE(0783)10597
6	Pro forma fuel expenditures	$ 585,210	UNSE(0783)10597
7	Test year expenditures	$ 573,746	
8	Staff Recommended pro forma adjustment to Fleet Fuel Expense	$ 11,464	L6-L7

C: **Line 6 Compare Amounts taken from the Company's response to STF 11.24**

		Gallons	Fuel Cost	Weighted Average Cost/Gal
9	Wright Express (September 2006 - May 2007)	51,891	$ 139,467	$ 2.69
10	Kingman Gascard (September 2006 - May 2007)	71,885	$ 192,615	$ 2.68
11	Parker Oil (February through May 2007)	7,775	$ 22,304	$ 2.87
12	Weighted Average	131,551	$ 354,386	$ 2.69

UNS Electric, Inc.
Adjustment to Fleet Fuel Expense (supplemental worksheet)
Allocation of Staff adjustment to FERC accounts

Docket No. E-04204A-06-0783
Schedule C-4 (Revised)

Test Year Ended June 30, 2006

Co	Acct	Expense Type	FERC Account	DR	CR	Net Amount	% of Total	O&M Adjustment	Staff Adjustment
33	55000	403	546	$7,634.11		$7,634.11	0.85%	$98	($530)
33	55000	403	548	$1,198.26		$1,198.26	0.13%	$15	($83)
33	55000	403	549	$188.36		$188.36	0.02%	$2	($13)
33	55000	403	551	$9,428.90		$9,428.90	1.05%	$121	($655)
33	55000	403	553	$17,592.83		$17,592.83	1.96%	$225	($1,222)
33	55000	403	554	$9,332.50		$9,332.50	1.04%	$119	($648)
33	55000	403	557	$2,550.60		$2,550.60	0.28%	$33	($177)
33	55000	403	562	$3,237.60		$3,237.60	0.36%	$41	($225)
33	55000	403	563	$472.61		$472.61	0.05%	$6	($33)
33	55000	403	566	$2,075.77		$2,075.77	0.23%	$27	($144)
33	55000	403	570	$7,633.80		$7,633.80	0.85%	$98	($530)
33	55000	403	571	$395.23		$395.23	0.04%	$5	($27)
33	55000	403	580	$8,414.78		$8,414.78	0.94%	$108	($584)
33	55000	403	581	$54,108.09		$54,108.09	6.04%	$693	($3,758)
33	55000	403	582	$4,099.30		$4,099.30	0.46%	$52	($285)
33	55000	403	583	$33,150.21		$33,150.21	3.70%	$424	($2,303)
33	55000	403	584	$65,053.92		$65,053.92	7.26%	$833	($4,518)
33	55000	403	585	$165.43		$165.43	0.02%	$2	($11)
33	55000	403	586	$98,161.79		$98,161.79	10.96%	$1,257	($6,818)
33	55000	403	587	$1,717.22		$1,717.22	0.19%	$22	($119)
33	55000	403	588	$43,342.83		$43,342.83	4.84%	$555	($3,010)
33	55000	403	590	$9,421.61		$9,421.61	1.05%	$121	($654)
33	55000	403	592	$53,782.89		$53,782.89	6.01%	$689	($3,736)
33	55000	403	593	$93,650.75		$93,650.75	10.46%	$1,199	($6,505)
33	55000	403	594	$18,195.04		$18,195.04	2.03%	$233	($1,264)
33	55000	403	595	$8,141.32		$8,141.32	0.91%	$104	($565)
33	55000	403	596	$8,089.99		$8,089.99	0.90%	$104	($562)
33	55000	403	598	$171.22		$171.22	0.02%	$2	($12)
33	55000	403	901	$24,434.41		$24,434.41	2.73%	$313	($1,697)
33	55000	403	902	$13,012.92		$13,012.92	1.45%	$167	($904)
33	55000	403	903	$132,933.49		$132,933.49	14.85%	$1,702	($9,233)
33	55000	403	905	$1,969.74		$1,969.74	0.22%	$25	($137)
33	55000	403	908	$7,737.47		$7,737.47	0.86%	$99	($537)
33	55000	403	909	$7,376.08		$7,376.08	0.82%	$94	($512)
33	55000	403	910	$181.63		$181.63	0.02%	$2	($13)
33	55000	403	920	$0.00		$0.00	0.00%	$0	$0
33	55000	403	921	$111,418.51		$111,418.51	12.44%	$1,426	($7,739)
33	55000	403	925	$165.65		$165.65	0.02%	$2	($12)
33	55000	403	930	$34,835.19		$34,835.19	3.89%	$446	($2,421)
				$895,472.05	$0.00	$895,472.05		$11,464	($62,196)
						Staff adjustment amount from page 1:		$11,464	$ (62,197)

UNS Electric, Inc.
Postage Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-5

Line No.	Description	Amount	Reference
1	UNS Electric Annualized Postage Expense	$ 341,321	A
2	Recommended Staff Annualized Postage Expense	$ 358,824	B
3	Adjustment to Annualized Postage Expense	$ 17,503	L2 - L1

Notes and Source

A: Per Company workpaper used in calculating its Postage Expense adjustment

B:

4	UNS Electric Annualized Postage Expense	$ 341,321
5	Postage increase effective 5/14/07 (.41/.39)	1.05
6	Staff adjusted annualized Postage Expense	$ 358,824

UNS Electric, Inc.
Normalize Injuries and Damages Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-6
Page 1 of 1

Line No.	Description	Amount	Reference
1	UNS Electric Test Year Injuries and Damages Expense	$ 562,403	A
2	Staff Recommended Normalized Injuries and Damages Expense	$ 403,340	B
3	Adjustment to Injuries and Damages Expense	$ (159,063)	L2 - L1

Notes and Source

A: Amount taken from UNS Electric's response to STF 3.101

B: Amounts taken from UNS Electric's response to STF 3.101

January through December 2004	$ 352,589
January through December 2005	$ 356,992
January through December 2006	$ 500,440
Total	$ 1,210,021
Normalized over three years	3
Staff Recommended Normalized Injuries and Damages Expense	$ 403,340

FERC Account 925

UNS Electric, Inc.
Incentive Compensation Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-7

Line No.	Description	Amount	Reference
1	Staff Adjustment to UES's Performance Enhancement Plan (PEP)	$ (17,962)	A
2	Staff Adjustment to UES's Other Incentive Comp	$ (24,486)	B
3	Total Adjustment to Incentive Compensation Expense	$ (42,448)	
4	Adjustment to Taxes Other Than Income	$ (1,553)	B

Notes and Source

A: Per Company's workpapers showing calculation of Incentive Compensation adjustment (except where noted)

FERC Acct	FERC Account Description	Company Amount	Disallowance Percentage	Staff Adjusted Amount
	Performance Enhancement Plan			
581	Distribution - Load Dispatching	$ 292	50%	$ 146
588	Distribution - Miscellaneous Expense	$ 3,428	50%	$ 1,714
593	Distribution - Maintenance of Overhead Lines	$ 3,612	50%	$ 1,806
901	Customer Accounting - Supervision	$ 5,374	50%	$ 2,687
903	Customer Records & Collection Expense	$ 585	50%	$ 293
909	Informational & Instructional Advertising Expense	$ 2,139	50%	$ 1,070
920	A&G Salaries	$ 20,491	50%	$ 10,246
		$ 35,921		$ 17,962
408	Taxes Other Than Income	$ 3,105	50%	$ 1,553

B: Per UNS Electric Inc.'s response to STF 3.83

FERC Acct	FERC Account Description	Company Amount	Disallowance Percentage	Staff Adjusted Amount
920	Deferred Compensation Plan	$ 9,035	50%	$ 4,518
923	Officer's Long Term Incentive Plan	$ 39,935	50%	$ 19,968
		$ 48,970		$ 24,486

UNS Electric, Inc.
Supplemental Executive Retirement Plant (SERP) Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-8

Line No.	Description	Amount	Reference
1	Remove Supplemental Executive Retirement Plan Expense	$ (83,506)	A

Notes and Source
A: Per the Company's response to STF 3.83

FERC 923

UNS Electric, Inc.
Stock Based Compensation Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-9

Line No.	Description	Amount	Reference
1	Remove Stock Based Compensation Expense	$ (82,873)	Note A

Notes and Source

A: Per Company's response to STF 10.11

Stock Option Expense	$	62,904
Performance Share Expense	$	19,969
Total	$	82,873

UNS Electric, Inc.
Property Tax Expense

Docket No. E-04204A-06-0783
Schedule C-10
Page 1 of 1

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	UNS Electric Proposed Decrease to Property Tax Expense	$ (130,301)	A
2	Staff Proposed Decrease to Property Tax Expense	$ (190,048)	B
3	Adjustment to Property Tax Expense	$ (59,747)	L2 - L1

Notes and Source
A: UNS Electric Filing, Schedule C-2, page 5, line 8
B: Amounts taken from Company workpapers used to calculate its property tax expense adjustment

	Utility Plant in Service Taxes	Generation	Transmission	Distribution	General/ Intangible	Total
4	Total Net Plant in Service - Rate Base	$ 18,471,624	$ 15,073,774	$ 99,401,194	$ 16,474,253	$ 149,420,845
5	Less: Non-Taxable Licensed Transportation in Rate Base	$ -	$ -	$ -	$ (3,834,788)	$ (3,834,788)
6	Less: Land Cost & Rights of Way in Rate Base	$ (408,603)	$ (681,822)	$ (695,700)	$ (30,719)	$ (1,816,844)
7	Less: Environmental Property in Rate Base	$ -	$ -	$ (5,563,286)		$ (5,563,286)
8	Less: Non-Taxable WAPA Portion of N Havasu Sub			$ (4,674,822)		$ (4,674,822)
9	Less: CWIP in Rate Base	$ (777,167)	$ (1,234,041)	$ (7,840,042)	$ (951,066)	$ (10,802,316)
10	Less: Net Book Value of Generation	$ (17,285,854)				$ (17,285,854)
11	Plus: Full Cash Value of Generation	$ 7,943,440				$ 7,943,440
12	Plus: Land FCV per AZ Department of Revenue			$ 1,551,539		$ 1,551,539
13	Plus: Materials and Supplies in Rate Base			$ 5,650,559		$ 5,650,559
14	Plant in Service Full Cash Value	$ 7,943,440	$ 13,157,911	$ 87,829,442	$ 11,657,680	$ 120,588,473
15	Assessment Ratio	23.5%	23.5%	23.5%	23.5%	
16	Taxable Value	$ 1,866,708	$ 3,092,109	$ 20,639,919	$ 2,739,555	$ 28,338,291
17	Average Tax Rate	9.6858%	9.6858%	9.6858%	9.6858%	
18	Property Tax - Subtotal	$ 180,806	$ 299,495	$ 1,999,141	$ 265,348	$ 2,744,790
19	Environmental Property in Rate Base	$ -	$ -	$ 5,563,286	$ -	
20	Statutory Full Cash Value Adjustment	50%	50%	50%	50%	
21	Environmental Full Cash Value	$ -	$ -	$ 2,781,643	$ -	
22	Assessment Ratio	23.5%	23.5%	23.5%	23.5%	
23	Taxable Value	$ -	$ -	$ 653,686	$ -	
24	Average Tax Rate	9.6858%	9.6858%	9.6858%	9.6858%	
25	Property Tax - Subtotal	$ -	$ -	$ 63,315	$ -	$ 63,315
26	Total Property Taxes	$ 180,806	$ 299,495	$ 2,062,456	$ 265,348	$ 2,808,105
27	Less: Recorded Property Taxes Excluding Call Center	$ (101,364)	$ (395,121)	$ (2,266,077)	$ (222,391)	$ (2,984,953)
28	Property Tax Expense Adjustment (subtotal)	$ 79,442	$ (95,626)	$ (203,621)	$ 42,957	$ (176,848)
29	Less: Estimated Property Tax Related to PHFFU					$ (13,200) *
30	Property Tax Expense Adjustment					$ (190,048)

*Plant Held for Future Use

	Transmission	Distribution	Total
Original Cost	$ 320,000	$ 120,000	$ 440,000
Estimated Property Tax Rate	3.0%	3.0%	
Estimated Property Tax Expense	$ 9,600	$ 3,600	$ 13,200

2008 Arizona Statutory Assessment Ratio 23.5%

FERC Account 408

UNS Electric, Inc.
Rate Case Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-11

Line No.	Description	Amount	Reference
1	UNS Electric Rate Case Expense per Company Filing	$ 200,000	A
2	Staff Recommended Rate Case Expense	$ 88,333	B
3	Adjustment to Rate Case Expense	$ (111,667)	L2 - L1

Notes and Source

A: UNS Electric Filing, Schedule C-2, page 3, line 6

B:

Staff Recommended Rate Case Expense	$ 265,000	Note 1
Normalized Over Three Years	3	
Staff Recommended Normalized Rate Case Expense	$ 88,333	

(1) Reflects an escalation of approximately 4% over the allowance recommended by Staff in the recent UNS Gas rate case

UNS Electric, Inc.
Edison Electric Institute Dues

Test Year Ended June 30, 2006

Line No.	Description	Test Year Amount (A)	Company Adjustment (B)	Company Adjusted Amount (C)	Staff Adjustment (D)	Staff Adjusted (E)
1	Regular Dues	$ 10,000	$ (2,000)	$ 8,000	$ (2,993) a	$ 5,007
2	2005 UARG	$ 24,071	$ -	$ 24,071	$ (2,675) b	$ -
3	2006 UARG	$ 2,802	$ -	$ 2,802	$ (2,802)	$ -
4	Total Test Year EEI Dues	$ 36,873	$ (2,000)	$ 34,873	$ (8,470)	$ 5,007
5	Journal Entry to Correct 2005 UARG per G/L	$ (21,396)	$ -	$ (21,396)	$ -	$ -
6	Adjusted Test Year EEI Dues	$ 15,477	$ (2,000)	$ 13,477	$ (8,470)	$ 5,007

Notes and Source

Col. A: Amounts taken from the Company's response to STF 3.72

a: Staff adjustment for Regular Dues based on a disallowance percentage of 49.93% (see page 2)

	Staff Adjustment
Regular Dues	$ 10,000
Regular Dues disallowance percentage	49.93%
Staff adjustment to Regular Dues	$ 4,993
Less: Company adjustment	$ (2,000)
Remaining Staff adjustment to Regular Dues	$ 2,993

b: Allocation of TEP's portion of 2005 UARG in the amount of $24,071 booked in error. Corrected by Journal Entry 910.

TEP allocation of 2005 UARG	$ 24,071
Correcting JE910	$ (21,396)
UNS Electric allocation of 2005 UARG	$ 2,675

Page 17 of Mr. Dukes' rebuttal testimony agrees that the UARG dues should be removed.

Col D: Per letter from Edison Electric Institute included in Company's workpapers for its EEI adjustment, 100% of environmental related separately funded activities are classified as "non-deductible" expenses

FERC 930

Edison Electric Institute
Schedule of Expenses by NARUC Category
For Core Dues Activities
For the Year Ended December 31, 2005

NARUC Operating Expense Category	% of Dues	Recommended Disallowance
Legislative Advocacy	20.38%	20.38%
Legislative Policy Research	6.02%	
Regulatory Advocacy	16.49%	16.49%
Regulatory Policy Research	13.99%	
Advertising	1.67%	1.67%
Marketing	3.68%	3.68%
Utility Operations and Engineering	11.31%	
Finance, Legal, Planning and Customer Service	18.75%	
Public Relations	7.71%	7.71%
Total Expenses	100.00%	49.93%

Comments:

* The above percentages represent expenses associated with EEI's core dues activities, based on the operating expense categories established by NARUC. Core expenses are those expenses paid for by shareholder-owned electric utilities' dues.

* The legislative advocacy percent will differ slightly for IRS reporting requirements. For 2005, the lobbying % for IRS reporting is 19.4%.

* Administrative expenses are included in the percentages listed above. Approximately 11% of EEI's core dues expenses are administrative.

UNS Electric, Inc.
Other Membership and Industry Association Dues

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-13

Line No.	Description	Amount	Reference
1	Arizona Utility Investors Association	$ 2,500	930
2	Alliance of Utility Shareholder Associations (AUSA)	$ 100	930
3	Golden Valley Chamber of Commerce	$ 70	930
4	Kingman Mohave Lions Club	$ 120	921/930
5	Kingman Rotary Club	$ 383	921/930
6	Kingman Route 66 Rotary Club	$ 508	921/930
7	Kingsmen	$ 125	930
8	Kiwanis Club of Havasu	$ 666	930
9	Mohave Museum of History & Arts	$ 200	930
10	Nogales-Santa Cruz Chamber of Commerce	$ 60	930
11	Arizona-Mexico Commission	$ 1,750	930.1
12	Total Membership Dues	$ 6,482	
		Total From Above	Adjustment
13	Total Amount Recorded in Account 921	$ 568	$ (568)
14	Total Amount Recorded in Account 930	$ 5,914	$ (5,914)
15	Total	$ 6,482	$ (6,482)

Notes and Source

Amounts taken from the Company's response to STF 3.72

L.11: Also see responses to data requests STF 3.55 and MM DR 2.27:
"The $1,750 for the Arizona-Mexico Commission should have been removed from expenses included in the revenue requirement. This invoice was overlooked in error and will be adjusted out of test year expense."

UNS Electric, Inc.
Interest Synchronization

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-14 (Revised)

Line No.	Description		Amount	Reference
1	Adjusted rate base	$	130,707,320	Schedule B
2	Weighted cost of debt		4.10%	Schedule D
3	Synchronized interest deduction	$	5,359,000	Line 1 x Line 2
4	Synchronized interest deduction per UNS Electric	$	5,819,157	Note A
5	Difference (decreased) increased interest deduction	$	(460,157)	Line 3 - Line 4
6	Combined federal and state income tax rates		38.598%	UNS Electric Sch. C-3
7	Increase (decrease) to income tax expense	$	177,611	

Notes and Source

A RUCO 1.10 2006 UNSE Lead-Lag Summary.xls
Also, UNS Electric filing, Schedule B-5, page 3 of 3, line 21

UNS Electric, Inc.
Depreciation Rates Correction

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Adjustment to Depreciation & Amortization Expense	$ (63,105)	A

Notes and Source

A: Per Company's workpapers used to calculate its depreciation expense adjustment (except where noted)

FERC	Description	UNS Electric Proforma Adj. to Depreciation Expense	Staff Proforma Adj. to Depreciation Expense	Staff Adjustment	Additional Reference
403	Depreciation Expense	$ 122,500	$ 57,628	$ (64,872)	Pages 2 & 3
404	Amortization of Utility Plant	$ 323,410	$ 323,410	$ -	Page 3
406	Amortization of Utility Plant Acquisition Adjustment	$ 137,076	$ 138,843	$ 1,767	Page 4
	Total	$ 582,986	$ 519,881	$ (63,105)	

UNS Electric, Inc.
Depreciation & Amortization Expense - Supplemental Worksheet

Docket No. E-04204A-06-0783
Schedule C-15

Test Year Ended June 30, 2006

Depreciation Annualization Adjustment

Line No.	FERC Account	Description	Balance at 6/30/06	Adjustments	Adjusted Balance	Depreciation Rate	Annualized Depreciation	
		A. Rates Per Company Proforma Adjustment						
1	392	Transportation Equipment - Class 1	$ 366,331	$ 10,369	$ 376,700	12.75%	$ 48,029	
2	392	Transportation Equipment - Class 2	$ 1,151,599	$ 32,595	$ 1,184,194	16.99%	$ 201,195	
3	392	Transportation Equipment - Class 3	$ 1,185,238	$ 33,548	$ 1,218,786	20.21%	$ 246,317	
4	392	Transportation Equipment - Class 4	$ 5,641,612	$ 159,683	$ 5,801,295	13.47%	$ 781,434	
5	392	Transportation Equipment - Class 5	$ 1,995,626	$ 56,485	$ 2,052,111	12.55%	$ 257,540	
7		Total Annualized Transportation Equip.					$ 1,534,515	
		B. Rates Per Response to STF 11.8						
8	392	Transportation Equipment - Class 1	$ 366,331	$ 10,369	$ 376,700	11.48%	$ 43,245	
9	392	Transportation Equipment - Class 2	$ 1,151,599	$ 32,595	$ 1,184,194	15.29%	$ 181,063	
10	392	Transportation Equipment - Class 3	$ 1,185,238	$ 33,548	$ 1,218,786	18.69%	$ 227,791	
11	392	Transportation Equipment - Class 4	$ 5,641,612	$ 159,683	$ 5,801,295	11.97%	$ 694,415	
12	392	Transportation Equipment - Class 5	$ 1,995,626	$ 56,485	$ 2,052,111	11.29%	$ 231,683	
13		Total Annualized Transportation Equip.					$ 1,378,197	
		C. Staff Adjustment						
14		Staff Adjustment Before Capitalization					$ (156,318)	L13 - L7
15		O&M Portion of Vehicle Depreciation					41.5%	
16		Staff Adjustment to Depreciation Expense					$ (64,872)	L14 x L15

Notes and Source

Staff proforma adjustment for Depreciation & Amortization based on revised depreciation rates for FERC account 392 - Transportation Equipment, which reflected a 10% net salvage rate that was inadvertently omitted from the depreciation study as addressed in the responses to STF 3.39 and STF 11.8

UNS Electric, Inc.
Depreciation & Amortization Expense - Supplemental Worksheet

Test Year Ended June 30, 2006

Depreciation Annualization Adjustment

Line No.	Description	Account 403	Account 404	O&M Exp.	Total
	UNS Electric Proforma Adjustment - Schedule 15.1, page 12				
1	Test Year Recorded	$ 14,308,205	$ 390,304	$ 332,503	$ 15,031,012
2	Annualized Depreciation	$ 16,110,715	$ 713,714		$ 16,824,429
3	Less: Depr on CWIP Removed	$ (449,816)			$ (449,816)
4	Vehicle Depreciation Chgs CWIP	$ (1,534,515)		$ 636,824	$ (897,691)
5	Adjusted Annualized Depreciation	$ 14,126,384	$ 713,714	$ 636,824	$ 15,476,922
6	Adjustment Amount	$ (181,821)	$ 323,410	$ 304,321	$ 445,910

Line No.	Description	Account 403	Account 404	O&M Exp.	Total
	Staff Proforma Adjustment - Schedule 15.2, page 8				
7	Test Year Recorded	$ 14,308,205	$ 390,304	$ 332,503	$ 15,031,012
8	Annualized Depreciation	$ 15,954,397	$ 713,714		$ 16,668,111
9	Less: Depr on CWIP Removed	$ (449,816)			$ (449,816)
10	Vehicle Depreciation Chgs CWIP	$ (1,378,197)		571,952	$ (806,245)
11	Adjusted Annualized Depreciation	$ 14,126,384	$ 713,714	$ 571,952	$ 15,412,050
12	Adjustment Amount	$ (181,821)	$ 323,410	$ 239,449	$ 381,038
13	Staff Adjustment				$ (64,872) L12 - L6

UNS Electric, Inc.
Depreciation & Amortization Expense - Supplemental Worksheet

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-15

Acquisition Discount Annualization Adjustment

Line No.	FERC Account	Description	Balance at 6/30/06	Adjustments	Adjusted Balance	Depreciation Rate	Annualized Depreciation	
		Rates Per Company Proforma Adjustment						
1	392	Transportation Equipment - Class 1	$ (51,192)	$ 39,563	$ (11,629)	12.75%	$ (1,483)	
2	392	Transportation Equipment - Class 2	$ (16,191)	$ 12,513	$ (3,678)	16.99%	$ (625)	
3	392	Transportation Equipment - Class 3	$ (92,982)	$ 71,860	$ (21,122)	20.21%	$ (4,269)	
4	392	Transportation Equipment - Class 4	$ (362,404)	$ 280,080	$ (82,324)	13.47%	$ (11,089)	
5	392	Transportation Equipment - Class 5	$ -	$ -	$ -	12.55%	$ -	
7		Total Annualized Amort-Acq Adj	$ (522,769)	$ 404,016	$ (118,753)		$ (17,466)	
		Rates Per Response to STF 11.8						
8	392	Transportation Equipment - Class 1	$ (51,192)	$ 39,563	$ (11,629)	11.48%	$ (1,335)	
9	392	Transportation Equipment - Class 2	$ (16,191)	$ 12,513	$ (3,678)	15.29%	$ (562)	
10	392	Transportation Equipment - Class 3	$ (92,982)	$ 71,860	$ (21,122)	18.69%	$ (3,948)	
11	392	Transportation Equipment - Class 4	$ (362,404)	$ 280,080	$ (82,324)	11.97%	$ (9,854)	
12	392	Transportation Equipment - Class 5	$ -	$ -	$ -	11.29%	$ -	
13		Total	$ (522,769)	$ 404,016	$ (118,753)		$ (15,699)	
14		Staff Adjustment					$ 1,767	L13 - L7

Proforma Adjustment to FERC Account 406

Line No.	Description	Per Company Adj. Workpaper	Staff Adjusted	Staff Adjustment
15	Intangible Plant	$ (181,550)	$ (181,550)	
16	Other Production Plant	$ (136,670)	$ (136,670)	
17	Transmission Plant	$ (400,629)	$ (400,629)	
18	Distribution Plant	$ (2,824,706)	$ (2,824,706)	
19	General Plant	$ (238,101)	$ (236,334)	
		$ (3,781,656)	$ (3,779,889)	
20	Test Year Amount per Books	$ (3,918,732)	$ (3,918,732)	
21	Adjustment - FERC 406	$ 137,076	$ 138,843	$ 1,767

Notes and Source

Staff proforma adjustment for Acquisition Discount Annualization Adjustment based on revised depreciation rates for FERC account 392 - Transportation Equipment, which reflected a 10% net salvage rate that was inadvertently omitted from the depreciation study as addressed in the responses to STF 3.39 and STF 11.8

UNS Electric, Inc.
Emergency Bill Assistance Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-16

Line No.	Description	Account	Amount	Reference
1	Increase to Emergency Bill Assistance Expense		$ 20,000	A

Notes and Source

A Testimony of Staff witnesses Ralph C. Smith and Julie McNeely-Kirwan

UNS Electric Inc.
Southwest Energy Services (SES) Charges

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Remove Mark-up Related to SES Charges	$ (10,906)	A

Notes and Source
A: Amount taken from UNS Electric's supplemental response to STF 15.1

Primarily FERC Account 902. See responses to data request STF 10.4 (direct billings) and STF 10.5 (indirect billings) for additional account details

UNS Electric Inc.
Bad Debt Expense

Docket No. E-04204A-06-0783
Schedule C-18

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	UNS Electric Adjustment to Bad Debt Expense per Filing	$ 222,556	A
2	UNS Electric Revised Adjustment to Bad Debt Expense	$ 66,947	B
3	Adjustment to Bad Debt Expense	$ (155,609)	L2 - L1

Notes and Source
A: UNS Electric filing, Schedule C-2, page 3, line 6
B: Rebuttal testimony of Company witness Dallas Dukes, pages 21 and 22 and workpaper UNSE(0783)10580

FERC Account 904

UNS Electric Inc.
Outside Services - Demand Side Management

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	Remove Double Count from Outside Services Related to DSM	$ (17,055)	A

Notes and Source
A: Rebuttal testimony of Company witness Dallas Dukes, page 27

FERC Account 908

UNS Electric Inc.
Year-End Accruals

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
Schedule C-20

Line No.	Description	Amount	Reference
1	Correct Year-End Accrual to Remove Prior Period Expense	$ (6,256)	A

Notes and Source
A: Rebuttal testimony of Company witness Dallas Dukes at page 22 and Rebuttal Exhibit DJD-1, page 3.

FERC Account 926

UNS Electric, Inc.
Purchased Power and Fuel Adjustment Clause
Plan of Administration

Table of Contents

1. GENERAL DESCRIPTION

This document describes the plan for administering the Purchased Power and Fuel Adjustment Clause ("PPFAC") the Arizona Corporation Commission ("Commission") approved for UNS Electric, Inc. ("UNSE") in Decision No. XXXXX [DATE]. The PPFAC provides for the recovery of fuel and purchased power costs from the date of that decision forward.

The PPFAC described in this Plan of Administration ("POA") uses a forward-looking estimate of fuel and purchased power costs to set a rate that is then reconciled to actual costs experienced. This POA describes the application of the PPFAC.

2. DEFINITIONS

Applicable Interest – Based on one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release H-15. The interest rate is adjusted annually on the first business day of the calendar year.

Base Cost of Fuel and Purchased Power – An amount generally expressed as a rate per kWh, which reflects the fuel and purchased power cost embedded in the base rates as approved by the Commission in UNSE's most recent rate case. The Base Cost of Fuel and Purchased Power revenue is the approved rate per kWh times the applicable sales volumes. Decision No. XXXXX set the base cost at $X.XXXX per kWh effective on [DATE].

Forward Component –An amount expressed as a rate per kWh charge that is updated annually on June 1 of each year and effective with the first billing cycle in June. The Forward Component for the PPFAC Year will adjust for the difference between the forecasted fuel and purchased power costs expressed as a rate per kWh less the Base Cost of Fuel and Purchased Power generally expressed as a rate per kWh embedded in UNSE's base rates. The result of this calculation will equal the Forward Component, expressed as a rate per kWh.

Forward Component Tracking Account – An account that records on a monthly basis UNSE's over/under-recovery of its actual costs of fuel and purchased power as compared to the actual Base Cost of Fuel and Purchased Power revenue and Forward Component revenue; plus Applicable Interest. The balance of this account as of the end of each PPFAC Year is, subject to periodic audit, reflected in the next True-Up Component calculation. UNSE files the balances and supporting details underlying this Account with the Commission on a monthly basis via a monthly reporting requirement.

Mark-to-Market Accounting – Recording the value of qualifying commodity contracts to reflect their current market value relative to their actual cost.

Native Load – Native load includes customer load in the UNSE control area for which UNSE has a generation service obligation.

PPFAC – The Purchased Power and Fuel Adjustment Clause approved by the Commission in Decision No. XXXXX that tracks changes in the cost of obtaining power supplies based upon forward-looking estimates of fuel and purchased power costs that are eventually reconciled to actual costs experienced as described herein.

PPFAC Rate - The combination of two rate components, the Forward Component and True-Up Component.

PPFAC Year - A consecutive 12-month period beginning each June 1 and lasting through May 31 the following year. The PPFAC will initially be set to zero on the date the Commission issues a decision in this proceeding (Decision No. XXXXX). The first year of the PPFAC will begin on June 1, 2008 and end on May 31, 2009.

System Book Fuel and Purchased Power Costs - The costs recorded for the fuel and purchased power used by UNSE to serve both Native Load and off-system sales, less the costs associated with applicable special contracts and Mark-to-Market Accounting adjustments. Wheeling costs and broker's fee are included.

Off-System Wholesale Sales Revenue - The revenue recorded from sales made to non-Native Load customers, for the purpose of optimizing the UNSE system, using UNSE-owned or contracted generation and purchased power, less Mark-to-Market Accounting adjustments.

Traditional Sales-for-Resale - The portion of load from Native Load wholesale customers that is served by UNSE.

True-Up Component - An amount expressed as a rate per kWh charge that is updated annually on June 1 of each year and effective with the first billing cycle in June. The purpose of this charge is to provide for a true-up mechanism to reconcile any over or under-recovered amounts from the preceding PPFAC Year tracking account balances to be refunded/collected from customers in the coming year's PPFAC rate.

True-Up Component Tracking Account – An account that records on a monthly basis the account balance to be collected or refunded via the True-Up Component rate as compared to the actual True-Up Component revenues, plus Applicable Interest; the balance of which at the close of the preceding PPFAC Year is, subject to periodic audit, then reflected in the next True-Up Component calculation. UNSE files the balances and supporting details underlying this Account with the Commission on a monthly basis.

Wheeling Costs (FERC Account 565, Transmission of Electricity by Others) - Amounts payable to others for the transmission of UNSE's electricity over transmission facilities owned by others.

3. PPFAC COMPONENTS

The PPFAC Rate will consist of two components designed to provide for the recovery of actual, prudently incurred fuel and purchased power costs. Those components are:

1. The Forward Component, which recovers or refunds differences between expected PPFAC Year (each June 1 through May 31 period shall constitute a PPFAC Year) fuel and purchased power costs and those embedded in base rates.

2. The True-Up Component, which tracks the differences between the PPFAC Year's actual fuel and purchased power costs and those costs recovered through the combination of base rates and the Forward Component, and which provides for their recovery during the next PPFAC Year.

The PPFAC Year begins on June 1 and ends the following May 31. The first full PPFAC Year in which the PPFAC rate shall apply will begin on June 1, 2008 and end on May 31, 2009. Succeeding PPFAC Years will begin on each June 1 thereafter.

For the period from when the Commission issued Decision No. XXXXX in this case – until June 1, 2008 – the Base Cost of Fuel and Purchased Power rate established in that decision will be in effect.

On or before December 31 of each year, UNSE will submit a PPFAC Rate filing, which shall include a proposed calculation of the components for the PPFAC Rate. This filing shall be accompanied by supporting information as Staff determines to be required. UNSE will supplement this filing with True-Up Component filing on or before April 1 in order to replace estimated balances with actual balances, as explained below.

A. Forward Component Description

The Forward Component is intended to refund or recover the difference between: (1) the fuel and purchased power costs embedded in base rates and (2) the forecasted fuel and purchased power costs over a PPFAC Year that begins on June 1 and ends the following May 31. UNSE will submit, on or before December 31 of each year, a forecast for the upcoming PPFAC year (June 1 through May 31) of its fuel and purchase power costs. It will also submit a forecast of kWh sales for the same PPFAC year, and divide the forecasted costs by the forecasted sales to produce the cents per kWh unit rate required to collect those costs over those sales. The result of subtracting the Base Cost of Fuel and Purchased Power from this unit rate shall be the Forward Component.

UNSE shall maintain and report monthly the balances in a Forward Component Tracking Account, which will record UNSE's over/under-recovery of its actual costs of fuel and purchased power as compared to the actual Base Cost of Fuel and Purchased Power revenue and Forward Component revenue. This account will operate on a PPFAC Year basis (i.e. June 1 to the following May 31), and its balances will be used to administer this PPFAC's True-Up Component, which is described immediately below.

Should an unusual event occur causing a drastic change in forecasted fuel and energy prices – such as a hurricane or other calamity – UNSE has the discretion to apply for an adjustment to the forward component. Such an adjustment ~~would only last until May 31 and~~ would not be implemented unless approved by ~~Staff and upon notice to~~ the Commission.

B. True-Up Component Description

The True-Up Component in any current PPFAC Year is intended to refund or recover the balance accumulated in the Forward Component Tracking Account (described above) during the previous PPFAC year. Also, any remaining balance from the True-Up Component Tracking Account as of May 31 would roll over into the True-Up Component for the coming PPFAC year starting June 1. The sum of projected Forward Component Tracking Account and True-Up Component Tracking Account balances on May 31 is divided by the forecasted PPFAC year kWh sales to determine the True-Up Component for the coming PPFAC year.

UNSE shall maintain and report monthly the balances in a True-Up Component Tracking Account, which will reflect monthly collections or refunds under the True-Up Component and the amounts approved for use in calculating the True-Up Component.

Each annual UNSE filing on December 31 will include an accumulation of Forward Component Tracking Account balances and True-Up Component Tracking Account balances for the preceding June through November and an estimate of the balances for December through May (the remaining six months of the current PPFAC Year). The UNSE filing shall use these balances to calculate a preliminary True-Up Component for the coming PPFAC Year. On or before April 1, UNSE will submit a supplemental filing that recalculates the True-Up Component. This recalculation shall replace estimated monthly balances with those actual monthly balances that have become available since the December 31 filing.

The December 31 filing's use of estimated balances for December through May (with supporting workpapers) is required to allow the PPFAC review process to begin in a way that will support its completion <u>and a Commission decision, if necessary,</u> before June 1. The April 1 updating will allow for the use of the most current balance information available before the PPFAC <u>rate</u> would go into effect. In addition to the April 1 update filing, UNSE monthly filings (for the months of November through April) of Forward Component Tracking Account balance information and True-Up Component Tracking Account balance information will include a recalculation (replacing estimated balances with actual balances as they become known) of the projected True-Up Component unit rate required for the next PPFAC Year.

The True-Up Component Tracking Account will measure the changes each month in the True-Up Component balance used to establish the current True-Up Component as a result of collections under the True-Up Component in effect. It will subtract each month's True-Up Component collections from the True-Up Component balance. The True-Up Component Account will also include Applicable Interest on any balances. UNSE shall file the amounts and supporting calculations and workpapers for this account each month.

4. CALCULATION OF THE PPFAC RATE

The PPFAC rate is the sum of the two components; i.e., Forward Component and True-Up Component. The PPFAC rate shall be applied to customer bills. Unless the Commission has otherwise acted on a new PPFAC rate by May 31, the proposed PPFAC rate (as amended by the updated April 1 filing) shall go into effect on June 1. The PPFAC rate shall be applicable to UNSE's retail electric rate schedules (except those specifically exempted) and is adjusted annually. The PPFAC Rate shall be applied to the customer's bill as a monthly kilowatt-hour ("kWh") charge that is the same for all customer classes.

The PPFAC rate shall be reset on June 1 of each year, and shall be effective with the first June billing cycle unless suspended by the Commission. It is not prorated.

5. FILING AND PROCEDURAL DEADLINES

A. December 31 Filing

UNSE shall file the PPFAC rate with all Component calculations for the PPFAC year beginning on the next June 1, including all supporting data, with the Commission on or before December 31 of each year. That calculation shall use a forecast of kWh sales and of fuel and purchased power costs for the coming calendar year, with all inputs and assumptions being the most current available for the Forward Component. The filing will also include the True-Up Component calculation for the year beginning on the next June 1, with all supporting data. That calculation will use the same forecast of sales used for the Forward Component calculation.

B. April 1 Filing

UNSE will update the December 31 filing by April 1. This update will replace estimated Forward Component Tracking Account balances~~,~~ and the True-Up Component Tracking Account balances with actual balances and with more current estimates for those months (March, April and May) for which actual data are not available. Unless the Commission has otherwise acted on the UNSE calculation by June 1, the PPFAC rate that UNSE proposed will go into effect on June 1.

C. Additional Filings

UNSE will also file with the Commission any additional information that the Staff determines it requires to verify the component calculations, account balances, and any other matter pertinent to the PPFAC.

D. Review Process

The Commission Staff and interested parties will have an opportunity to review the December 31 and April 1 forecast, balances, and supporting data on which the calculations of the two PPFAC components have been based. Any objections to the December 31 calculations must be filed within 45 days of the UNSE filing. Any objections to the April 1 calculations must be filed within 15 days of the UNSE filing~~ (i.e. by April 15.)~~.

E. Extraordinary Circumstances

Should an unusual event occur that causes a drastic change in forecasted fuel and energy prices – such as a hurricane or other calamity – UNSE will have the ~~authority~~ability to request an adjustment to the forward component reflecting such a change. ~~Staff must review and either approve, modify or deny UNSE's request within 30 days. This adjustment will only last until May 31, or the end of the current PPFAC Year.~~The Commission may provide for the change over such period as the Commission determines appropriate.

6. VERIFICATION AND AUDIT

The amounts charged through the PPFAC will be subject to periodic audit to assure their completeness and accuracy and to assure that all fuel and purchased power costs were incurred reasonably and prudently. The Commission may, after notice and opportunity for hearing, make such adjustments to existing balances or to already recovered amounts as it finds necessary to correct any accounting or calculation errors or to address any costs found to be unreasonable or imprudent. Such adjustments, with appropriate interest, shall be recovered or refunded in the True-Up Component for the following year (i.e. starting the next June 1.)

7. CALCULATIONS

A. Schedule 1: PPFAC Rate Calculation

[Specifics to be determined after reviewing illustrative schedules.]
~~Enter the appropriate effective periods for the Current and Proposed PPFAC columns and then complete the following in each respective column:~~

1. ~~On Line 1, enter the Forward Component from Schedule 2, Line 8.~~
2. ~~On Line 2, enter the True-Up Component from Schedule 4, Line 5.~~
3. ~~On Line 3, enter the sum of Lines 1 and 2 to calculate the total PPFAC Rate.~~
4. ~~Calculate the Increase/(Decrease) in rates and % Change by respective lines:~~
   ~~Proposed Rates Less Current Rates equals Increase/(Decrease) with result divided by Current Rate to determine % of Increase/(Decrease).~~

~~Reflect notes as appropriate.~~

B. Schedule 2: PPFAC Forward Component Rate Calculation

[Specifics to be determined after reviewing illustrative schedules.]
~~Enter the appropriate effective periods for the Current and Proposed PPFAC columns and then complete the following in each respective column:~~

1. ~~On Line 1, enter the Projected Fuel and Purchased Power Costs for the coming year.~~
2. ~~On Line 2, enter 90% of the Projected Off System Sales Revenue (entered as a negative value) for the coming year.~~
3. ~~On Line 3, enter the PPFAC Adjustments to Fuel and Purchased Power Costs for the coming year.~~
4. ~~On Line 4, enter the sum of Lines 1 through 3 to arrive at the Net Fuel and Purchased Power Costs.~~
5. ~~On Line 5, enter the Projected Native Load Sales (MWh), including Wholesale Native Load Customers for the coming year.~~
6. ~~On Line 6, enter the derivation of the Net Fuel and Purchased Power Costs divided by the Projected Native Load Sales to arrive at the Projected Average Net Fuel Cost per kWh.~~
7. ~~On Line 7, enter the Authorized Base Cost of Fuel and Purchased Power Rate per kWh.~~
8. ~~On Line 8, enter the sum of Line 6 less Line 7 to arrive at the Forward Component rate per kWh; and then carry forward resultant value to Schedule 1, Line 1.~~

~~Reflect notes as appropriate.~~

C. Schedule 3: Forward Component Tracking Account

[Specifics to be determined after reviewing illustrative schedules.]

~~Enter the appropriate: effective dates for the PPFAC Forward Component currently being tracked; year for the column headed "Cycle Billing Month"; and Base Rate and Forward Component in columns h and i. On lines 1 through 12 under the Cycle Billing Month, January through December for each respective column complete the following:~~

1. ~~On Lines 1 to 12, enter the monthly PPFAC Retail Energy Sales (MWh) and the monthly Wholesale Native Load Energy Sales in columns a and b, respectively. The sum of columns a and b equals the Total Native Load Energy Sales in column c. Currently, Wholesale Native Load Energy Sales include Traditional Sales for Resale and any Supplemental Sales.~~
2. ~~On Lines 1 to 12, enter the monthly System Book Fuel and Purchased Power Costs and 90% of the monthly System Book Off System Sales Revenue in columns d and e, respectively:~~

   - ~~The sum of column d minus e equals the monthly Net Native Load Power Supply Costs in column f.~~

- ~~The off-system sales margin is embedded in the Net Native Load Power Supply Cost. The costs associated with the off-system sales are included in the System Book Fuel and Purchased Power Costs.~~
- ~~When the System Book Off-System Sales Revenue is subtracted from the System Book Fuel and Purchased Power Costs, the difference between the off-system sales costs and revenue ends up in the Net Native Load Power Supply Cost. That difference is the off system sales margin.~~
- ~~A list of the items included in the PPFAC sales and costs described above will be included in the PPFAC reporting schedules filed with the Commission each month.~~

3. ~~On Lines 1 to 12, calculate the PPFAC Retail Power Supply Costs, column g by dividing the PPFAC Retail Energy Sales in column a by the Total Native Load Energy Sales in column c, then multiply the product by the Net Native Load Power Supply Costs in column f.~~
4. ~~On Lines 1 to 12, calculate the amount recovered via the Commission approved embedded base fuel and purchased power rate by multiplying the Retail Energy Sales in column a by the Commission approved Base Cost of Fuel and Purchased Power rate entered in the above column heading the result which is entered in column h.~~
5. ~~On Lines 1 to 12, calculate the amount recovered via the Forward Component rate by multiplying said rate by the Retail Energy Sales in column a, the result which is entered in column i.~~
6. ~~On lines 1 to 12, calculate the respective level of (Over)/Under Collection in column j by subtracting the Base Rate Power Supply Recovery and the Forward Component Recovery from the PPFAC Retail Power Supply Costs, columns g and h, respectively.~~

~~An interest rate, based on the one-year Nominal Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release, H-15, is applied each month to the previous month's Tracking Account Balance. The interest rate is adjusted annually on the first business day of the calendar year in the same manner as the UNSE customer deposit rate.~~

~~The (Over)/Under Collection, the Interest and the prior month's Tracking Account Balance produce the current month's balance.~~

D. Schedule 4: PPFAC True-Up Component Rate Calculation

[Specifics to be determined after reviewing illustrative schedules.]

~~Enter the appropriate effective periods for the Current and Proposed PPFAC-2 columns and then complete the following in each respective column:~~

1. ~~On Line 1, enter the Forward Component Tracking Account Balance from Schedule 3, Line13, column i.~~
2. ~~On Line 2, enter the True Up Component Tracking Account Balance from Schedule 5, Line 8.~~

3. ~~On Line 3, enter the sum of Lines 1, and 2 to arrive at the Total (Refundable)/Collection Amount Balance.~~
4. ~~On Line 4, enter the respective Projected Energy Sales (MWh).~~
5. ~~On Line 5, enter the Applicable True Up Component rate by dividing Line 3 by Line 4.~~

~~Reflect notes as appropriate.~~

E. Schedule 5: True-Up Component Tracking Account

[Specifics to be determined after reviewing illustrative schedules.]

~~Enter the appropriate: effective dates for the PPFAC Prior True Up Component being tracked:~~

~~On Line 8, for May and Line 1 for June, enter the True Up Component balance as of June 1, 20XX. On Line 2, (Prior period PPFAC True Up Component Calculation From Schedule 4, Line 4) for June enter any true up for the use of prior period estimates, (i.e. prior estimated March, April and May True Up Component rate application revenues to subsequent actual data), the sum of Lines 1 and 2, to reflect the Adjusted True Up Component Beginning Balance as of June 1, 20XX.~~

~~Each month, the Applicable True Up Component rate is multiplied by the Retail Energy Sales to calculate the revenue received from the Applicable True Up Component rate. The revenue is subtracted from the Adjusted Beginning Balance.~~

~~Interest is applied monthly based on the effective one-year Nominal Treasury Constant Maturities rate that is contained in the Federal Reserve Statistical Release, H-15, or its successor publication. The interest rate is adjusted annually on the first business day of the PPFAC Year.~~

~~Reflect notes as appropriate.~~

8. COMPLIANCE REPORTS

UNSE shall provide monthly reports to Staff's Compliance Section and to the Residential Utility Consumer Office detailing all calculations related to the PPFAC. A UNSE Officer shall certify under oath that all information provided in the reports itemized below is true and accurate to the best of his or her information and belief. These monthly reports shall be due within 30 days of the end of the reporting period.

The publicly available reports will include at a minimum:

1. The PPFAC Rate Calculation (Schedule 1); Forward Component and True-Up Component Calculations (Schedules 2 and 4); Annual Forward Component and,

True-Up Component Tracking Account Balances (Schedules 3 and 5). Additional information will provide other relative inputs and outputs such as:

a. Total power and fuel costs.
b. Customer sales in both MWh and thousands of dollars by customer class.
c. Number of customers by customer class.
d. A detailed listing of all items excluded from the PPFAC calculations.
e. A detailed listing of any adjustments to the adjustor reports.
f. Total off-system sales revenues.
g. System losses in MW and MWh.
h. Monthly maximum retail demand in MW.

2. Identification of a contact person and phone number from UNSE for questions.

UNSE shall also provide to Commission Staff monthly reports containing the information listed below. These reports shall be due within 30 days of the end of the reporting period. All of these additional reports must be provided confidentially.

A. Information for each generating unit will include the following items:
   1. Net generation, in MWh per month, and 12 months cumulatively.
   2. Average heat rate, both monthly and 12-month average.
   3. Equivalent forced-outage rate, both monthly and 12-month average.
   4. Outage information for each month including, but not limited to, event type, start date and time, end date and time, and a description.
   5. Total fuel costs per month.
   6. The fuel cost per kWh per month.

B. Information on power purchases will include the following items per seller (information on economy interchange purchases may be aggregated):
   1. The quantity purchased in MWh.
   2. The demand purchased in MW to the extent specified in the contract.
   3. The total cost for demand to the extent specified in the contract.
   4. The total cost of energy.

C. Information on off-system sales will include the following items:
   1. An itemization of off-system sales margins per buyer.
   2. Details on negative off-system sales margins.

D. Fuel purchase information shall include the following items:
   1. Natural gas interstate pipeline costs, itemized by pipeline and by individual cost components, such as reservation charge, usage, surcharges and fuel.
   2. Natural gas commodity costs, categorized by short-term purchases (one month or less) and longer term purchases, including price per therm, total cost, supply basin, and volume by contract.

E. UNSE will also provide:

1. Monthly projections for the next 12-month period showing estimated (Over)/undercollected amounts.
2. A summary of unplanned outage costs by resource type.
3. The data necessary to arrive at the System and Off-System Book Fuel and Purchased Power cost reflected in the non-confidential filing.
4. The data necessary to arrive at the Native Load Energy Sales MWh reflected in the non-confidential filing.

Work papers and other documents that contain proprietary or confidential information will be provided to the Commission Staff under an appropriate protective agreement. UNSE will keep fuel and purchased power invoices and contracts available for Commission review. The Commission has the right to review the prudence of fuel and power purchases and any calculations associated with the PPFAC at any time~~within XX years of those costs being incurred~~. Any costs flowed through the PPFAC are subject to refund, if those costs are found to be imprudently incurred.

9. ALLOWABLE COSTS

A. Accounts

The allowable PPFAC costs include fuel and purchased power costs incurred to provide service to retail customers. Additionally, the prudent direct costs of contracts used for hedging system fuel and purchased power will be recovered under the PPFAC. The allowable cost components include the following Federal Energy Regulatory Commission ("FERC") accounts:

- 501 Fuel (Steam)
- 547 Fuel (Other Production)
- 555 Purchased Power
- 565 Wheeling (Transmission of Electricity by Others)

These accounts are subject to change if the Federal Energy Regulatory Commission alters its accounting requirements or definitions.

B. Other Allowable Costs

~~In addition to the fuel and purchased power costs in the above mentioned FERC accounts, the following costs will also be recovered through the PPFAC:~~
~~•Energy procurement, scheduling and management fees allocated to UNSE from TEP.~~
~~•Credit costs necessary to support fuel and purchased power contracts~~
~~•Any and all federal and/or state carbon taxes applied to UNSE's generation or fuel and purchased power contracts~~
~~•Outside legal expenses incurred to litigate fuel and purchased power matters on behalf of UNSE's customers, such as pipeline and transmission rate cases and contract disputes~~
~~•Amortized interstate pipeline and electric transmission interconnection costs~~None without pre-approval from the Commission in an Order..

Attachment RCS-8
Copies of UNS Electric's Responses to Data Requests and Workpapers Referenced in the Surrebuttal Testimony and Schedules of Ralph C. Smith

[1] The attachment noted in the response to STF-3.88 is not included.

UNS Electric, Inc.
Fleet Fuel Expense - Invoices
July 2006 - June 2007 – Full 12 months

Back-up for invoices from 7/2006 - 9/2006 and 5/2007 - 6/2007 refer to pages 7.10-7.70
The other months are from STF 11.24 Page 7.[illegible] 7.[illegible]

Invoice Date	Gallons	Fuel Cost	Cost/Gallon
Wright Express Invoices			
7/6/2006	12,475	$37,944.79	$3.04
8/6/2006	12,678	$38,244.38	$3.02
9/6/2006	11,681	$34,985.15	$3.00
10/9/2006	7,678	$21,262.37	$2.77
11/7/2006	8,163	$20,690.44	$2.53
12/6/2006	5,878	$15,380.32	$2.62
1/6/2007	5,432	$14,316.33	$2.64
2/7/2007	6,283	$16,187.27	$2.58
3/7/2007	5,808	$14,937.11	$2.57
4/6/2007	6,503	$18,338.70	$2.82
5/6/2007	6,144	$18,354.94	$2.99
6/6/2007	6,729	$21,638.24	$3.22
	95,454	$272,280.04 7.7b	$2.85
Kingman Gascard			
7/5/2006	2,644	$7,844.45	$2.97
7/20/2006	2,441	$7,241.97	$2.97
8/5/2006	2,542	$7,848.05	$3.09
8/20/2006	2,071	$6,306.43	$3.05
9/5/2006	1,237	$3,862.25	$3.12
9/20/2006	3,612	$10,177.01	$2.82
10/5/2006	5,306	$14,208.66	$2.68
10/20/2006	4,578	$11,687.15	$2.55
11/5/2006	4,730	$11,880.83	$2.51
11/20/2006	5,079	$13,089.11	$2.58
12/5/2006	4,055	$10,891.93	$2.69
12/20/2006	6,373	$17,250.81	$2.71
1/5/2007	4,364	$13,746.23	$3.15
1/20/2007	4,951	$10,489.23	$2.12
2/5/2007	5,361	$13,260.98	$2.47
2/20/2007	6,249	$16,235.41	$2.60
3/5/2007	3,387	$9,181.32	$2.71
3/20/2007	4,148	$11,538.48	$2.78
4/5/2007	5,187	$14,657.28	$2.83
4/27/2007	4,371	$13,036.70	$2.98
5/5/2007	3,745	$11,460.83	$3.06
5/20/2007	3,888	$11,736.74	$3.02
6/5/2007	3,926	$11,709.83	$2.98
6/20/2007	5,174	$15,590.35	$3.01
	99,420	$274,932.03 7.7c	$2.77
Parker Oil			
2/28/2007	1,103	$2,789.54	$2.53
3/16/2007	974	$2,521.62	$2.59
3/31/2007	555	$1,445.36	$2.60
4/1/2007	2,064	$6,030.15	$2.92
4/1/2007	(2,064)	($5,257.87)	$2.55
4/16/2007	835	$2,565.84	$3.07
4/30/2007	1,051	$3,250.72	$3.09
5/16/2007	1,192	$3,700.57	$3.10
5/31/2007	1,106	$3,448.00	$3.12
6/16/2007	909	$2,822.44	$3.10
6/30/2007	1,051	$3,247.25	$3.09
	8,777	$26,563.62 7.7d	$3.03
Texmo Oil Company			
8/29/2006	435	$1,349.79	$3.10
8/30/2006	705	$2,190.40	$3.11
8/31/2006	304	$987.07	$3.25
8/31/2006	275	$889.71	$3.24
9/6/2006	430	$1,364.23	$3.17
9/7/2006	420	$1,330.63	$3.17
9/11/2006	561	$1,672.00	$2.98
9/12/2006	185	$566.54	$3.06
9/13/2006	345	$1,084.39	$3.14
	3,660	$11,434.76 7.7e	$3.12
Total Fuel Cost	207,310	$585,210	$2.82 a

The table was derived by pulling oivoices from the vendors and summarizing

UNS ELECTRIC, INC.'S SUPPLEMENTAL RESPONSE TO STAFF'S FIFTEENTH SET OF DATA REQUESTS DOCKET NO. E-04204A-06-0783 July 13, 2007

STF 15.1 Southwest Energy Services (SES) charges. Refer to the responses to STF 10.4, STF 10.5, and STF 10.6.

a. The response to STF 10.6 indicates that "SES charges a 10% mark-up on the base wages of the supplemental worker." For each of the amounts of SES charges listed on the responses to STF 10.4 and STF 10.5, please identify the amount of the SES 10% mark-up over base wages. If exact amounts are not available, please provide the Company's best estimates of the SES 10% mark-up charges and show how such estimates were derived.

b. Do the SES charges to UNS Electric listed in the responses to STF 10.4 and STF 10.5 include any incentive compensation in the benefits cost? If so, please identify the amount of incentive compensation included in the SES charges to UNS Electric listed in the responses to STF 10.4 and STF 10.5.

c. Please list the benefits cost, by type of benefit, that is included in the SES charges to UNS Electric.

d. Is the 10% SES mark-up over base wages specified in a written contract? If so, please provide the contract, and indicate specifically where in the contract the 10% markup is specified.

RESPONSE: UNS Electric is in the process of gathering information and will provide the response to this data request as soon as the compilation is complete.

SUPPLEMENTAL RESPONSE:

a. The supplemental workforce for UniSource Energy Services, Inc. consists of electric and gas meter readers and warehouse personnel in Santa Cruz County. The amounts of the mark-ups over base wages on the SES supplemental workforce are $10,906 for test-year ended June 30, 2006; $8,183 for 2005; and $11,228 for 2006. The mark-up represents 6.5% of the total billings.

b. There is no incentive compensation in the benefit costs.

c. The supplemental workforce benefits consist of one charge of $4.37 per supplemental employee per hour worked, paid to the International Brotherhood of Electrical Workers, for health, dental, vision, life, the Employee Assistance Program, and short-term and long-term disability.

UNS ELECTRIC, INC.'S SUPPLEMENTAL RESPONSE TO STAFF'S FIFTEENTH SET OF DATA REQUESTS DOCKET NO. E-04204A-06-0783 July 13, 2007

d. Please see STF 15.1 (d), Bates Nos. UNSE(0783)10004 to UNSE(0783)10012 for the written contract. The 10% markup is specified on page 3 of STF 15.1 (d). Bates Nos. UNSE(0783)10004 to UNSE(0783)10012 contain confidential information and are being provided pursuant to the terms of the Protective Agreement.

RESPONDENT: Bob Dame

WITNESS: Tom Ferry and Edmond Beck

ATTACHMENT

RCS 8

PAGES 5-13

IS

CONFIDENTIAL

UNSE(0783)10580

UNS ELECTRIC, INC.
BAD DEBT EXPENSE
FOR TEST YEAR ENDED JUNE 30, 2006

REVISED - USING ACTUAL NET EXPENSE AND 3-YR AVERAGE RATE NET WRITE-OFF RATE

Test Year Retail Revenues	$153,864,975			
Add: Late Fees and Misc Service Revenues	$813,854			
	$154,678,829			
Rate Case Adjustments				
Weather Normalization	($410,061)			
Customer Annualization	$3,249,883			
Uncollectible Revenue Adjustment Base	$157,518,651			
3 Year Average Retail Write Off Rate	0.26913% (2)			
Pro Forma Bad Debt Expense	$423,929			
			As filed	$222,556 6.1a
Recorded Test Year Bad Debt Expense	$356,982		Revised	$66,947
			Change	($155,609)
Adjustment Required	$66,947 (1)			

Bad Debt expense

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2004	49,957.38	46,639.19	51,624.27	43,622.79	52,662.03	61,180.47	0.00	0.00	0.00	0.00	55,638.28	65,080.91	6.2a 426,405.32
2005	0.00	0.00	0.00	45,096.77	0.00	21,244.59	31,052.65	39,048.51	43,332.19	44,413.73	53,552.67	18,686.59	6.3a 296,427.70
2006	2,805.43	17,400.13	4,560.44	33,928.82	24,143.96	44,056.62	70,388.16	38,884.82	86,727.44	44,414.86	115,341.32	12,478.82	6.4a 495,130.82
3 Year Bad Debt Expense													$ 1,217,963.84

Unadjusted Retail Revenue

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2004	10,723,244.04	10,168,520.58	10,465,221.12	9,796,018.69	11,810,791.39	13,716,983.29	15,746,413.61	16,568,862.89	12,694,013.87	10,760,258.41	9,916,804.52	11,319,748.60	143,686,860.99
2005	11,210,737.07	9,933,237.90	10,440,160.60	9,814,174.13	12,064,796.79	14,598,843.91	17,774,045.88	16,235,323.56	13,757,683.70	11,539,171.78	10,032,506.58	11,901,792.54	149,302,474.44
2006	11,590,696.45	10,498,373.82	11,854,661.17	10,181,712.70	13,592,197.41	15,720,663.68	18,908,795.79	17,713,429.98	14,066,878.60	11,822,917.60	10,232,895.68	12,369,910.71	158,652,133.59
3 Year Retail Revenue													292,989,335.43

% Actual Retail Net Write Off to Retail Revenue

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2004	0.0046588	0.0045866	0.0049329	0.0044531	0.0044588	0.0044602	0.0000000	0.0000000	0.0000000	0.0000000	0.0056105	0.0057493	0.0029676
2005	0.0000000	0.0000000	0.0000000	0.0045951	0.0000000	0.0014552	0.0017471	0.0024052	0.0031497	0.0038490	0.0053379	0.0015701	0.0019854
2006	0.000242042	0.001657412	0.000384696	0.003332329	0.00177631	0.002802466	0.003722509	0.002195217	0.006165803	0.003725167	0.011271621	0.001008804	0.0031209
3 Year Average Retail Write Off Rate													(2) 0.0026913

6

**UNS ELECTRIC, INC.'S RESPONSES TO
STAFF'S THIRD SET OF DATA REQUESTS
DOCKET NO. E-04204A-06-0783
May 17, 2007**

STF 3.88 Filing Information. As the Company discovers errors in its filing identify such errors and provide documentation to support any changes. Please update this response as additional information becomes available.

RESPONSE: As the Company discovers errors in its filing, it will identify such errors and provide documentation to support any changes.

To date, TEP would like to revise two numbers referenced in Mr. James Pignatelli's Direct Testimony:

1) Page 3, line 19, the cost of debt is shown as 8.08%. Schedule D, however, reflects the accurate cost of debt as 8.22%.

2) Page 4, Line 12, the accurate customer count at the end of the test year is 91,860, not 91,850.

Please see STF 3.88 (Pignatelli DT), Bates Nos. UNSE(0783)06750 to UNSE(0783)06754, on the enclosed CD for supporting documentation.

RESPONDENT: Legal Department

WITNESS: Kent Grant – Cost of Debt
Thomas Ferry – Customer Count

Attachment RCS-9
Overtime Payroll Calculations for UNS Gas and UNS Electric
Accompanying the Surrebuttal Testimony of Ralph C. Smith

UNS Gas, Inc.
Overtime Payroll Expense

Docket No. G-04204A-06-0463
Schedule C-9
Page 1 of 2

Test Year Ended December 31, 2005

Line No.	Description	Amount	Reference
1	UNS Gas Proposed Overtime Expense	$ 1,070,133	A
2	Staff Recommended Overtime Expense	$ 947,123	B
3	Adjustment to Overtime Expense	$ (123,010)	L2 - L1

Notes and Source

A: UNS Gas workpaper used to calculate its payroll adjustment

B: Amounts taken from UNS Gas workpapers used to calculate its payroll adjustment

		2004	2005	2 Year Average
4	Overtime Charged Directly to O&M - Classified	$ 450,802	$ 871,111	$ 660,957
5	Overtime Charged Directly to O&M - Unclassified	$ 330,584	$ 129,333	$ 229,959
6	Total Overtime Charged Directly to O&M	$ 781,386	$ 1,000,445	$ 890,915
7	Regular Annualized O&M Payroll	$ 5,472,931		
8	Adjusted 2005 Regular O&M Wages per Books	$ 5,148,145		
9	Increase to Regular O&M Payroll	1.06309		
10	Two Year Average Overtime Charged to O&M	$ 890,915		
11	Increase to Regular Payroll	1.06309		
12	Staff Recommended Increase to Overtime	$ 947,123		

UNS Gas, Inc.
Adjustment to Overtime Payroll Expense - Alternative Calculation

Test Year Ended December 31, 2005

Docket No. G-04204A-06-0463
Schedule C-9
Page 2 of 2

Line No.	Description	Amount	Reference
1	UNS Gas Proposed Total Overtime	$ 1,402,549	A
2	Staff Normalized Total Overtime	$ 1,220,536	B
3	Difference	$ (182,013)	L2 - L1
4	O&M Percentage	0.7630	C
5	Alternative Adjustment to Overtime Expense	$ (138,876)	

Notes and Source

A: UNS Gas workpaper used to calculate its payroll adjustment

B: Amounts taken from UNS Gas workpapers used to calculate its payroll adjustment

		2004	2005	2 Year Average
6	Overtime Charged Directly to O&M - Classified	$ 450,802	$ 871,111	$ 660,957
7	Overtime Charged Directly to O&M - Unclassified	$ 330,584	$ 129,333	$ 229,959
8	Overtime Charged to Non-O&M Accounts	$ 211,113	$ 303,260	$ 257,187
9	Total Overtime Charged Directly to O&M	$ 992,499	$ 1,303,705	$ 1,148,102

10	Regular Annualized O&M Payroll	$ 8,868,400
11	Adjusted 2005 Regular O&M Wages per Books	$ 8,342,113
12	Increase to Regular O&M Payroll	1.06309
13	Two Year Average Overtime Charged to O&M	$ 1,148,102
14	Increase to Regular Payroll	1.06309
15	Staff Recommended Increase to Overtime	$ 1,220,536

C:

16	Normalized Overtime Charged to O&M per Company	$ 1,070,133
17	Total Normalized Overtime per Company	$ 1,402,549
18	Percentage of Overtime Charged to O&M	0.7630

UNS Electric, Inc.
Overtime Payroll Expense

Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
UNSE Overtime Staff W/P
Page 1 of 3

Line No.	Description	Amount	Reference
1	UNS Electric Proposed Overtime Expense	$ 823,097	A
2	Staff Recommended Overtime Expense	$ 887,319	B
3	Adjustment to Overtime Expense	$ 64,222	L2 - L1

Notes and Source

A: UNS Electric workpaper used to calculate its payroll adjustment

B: Amounts taken from UNS Electric workpapers used to calculate its payroll adjustment

		2004	2005	2 Year Average
4	Overtime Charged Directly to O&M - Classified	$ 740,770	$ 893,703	$ 817,236
5	Overtime Charged Directly to O&M - Unclassified	$ 25,091	$ 24,645	$ 24,868
6	Total Overtime Charged Directly to O&M	$ 765,861	$ 918,347	$ 842,104

7	Regular Annualized O&M Payroll	$ 3,267,815	
8	Test Year Regular O&M Wages per Books	$ 3,101,296	
9	Increase to O&M Payroll	1.05369	L7 / L8
10	Two Year Average Overtime Charged to O&M	$ 842,104	
11	Increase to Regular Payroll	1.05369	
12	Staff Recommended Increase to Overtime	$ 887,319	L10 x L11

UNS Electric, Inc.
Adjustment to Overtime Payroll Expense - Alternative Calculation

Docket No. E-04204A-06-0783
UNSE Overtime Staff W/P
Page 2 of 3

Test Year Ended June 30, 2006

Line No.	Description	Amount	Reference
1	UNS Electric Proposed Total Overtime	$ 1,785,904	A
2	Staff Normalized Total Overtime	$ 1,675,291	B
3	Difference	$ (110,613)	L2 - L1
4	O&M Percentage	0.4609	C
5	Alternative Adjustment to Overtime Expense	$ (50,981)	

Notes and Source
A: UNS Electric workpaper used to calculate its payroll adjustment
B: Amounts taken from UNS Electric workpapers used to calculate its payroll adjustment

		2004	2005	2 Year Average
6	Overtime Charged Directly to O&M - Classified	$ 740,770	$ 893,703	$ 817,236
7	Overtime Charged Directly to O&M - Unclassified	$ 25,091	$ 24,645	$ 24,868
8	Overtime Charged to Non-O&M Accounts	$ 687,071	$ 808,577	$ 747,824
9	Total Overtime	$ 1,452,931	$ 1,726,925	$ 1,589,928
10	Regular Annualized Payroll	$ 8,261,628		
11	Test Year Regular Wages per Books	$ 7,840,637		
12	Increase to Regular O&M Payroll	1.05369	L10 / L11	
13	Two Year Average Overtime Payroll	$ 1,589,928		
14	Increase to Regular Payroll	1.05369		
15	Staff Recommended Increase to Overtime	$ 1,675,291	L13 x L14	

C:

16	Normalized Overtime Charged to O&M per Company	$ 823,096	
17	Total Normalized Overtime per Company	$ 1,785,904	
18	Percentage of Overtime Charged to O&M	0.4609	L16 / L17

UNS Electric, Inc.
Normalization of Classified Overtime Expense
Test Year Ended June 30, 2006

Docket No. E-04204A-06-0783
UNSE Overtime Staff W/P
Page 3 of 3
UNSE witness Dukes' workpaper

	2004	2005	2-Yr Average
Overtime Charged Directly to O&M - Classified	740,769.94	893,702.86	817,236.40
Regular Wages Charged Directly to O&M - Classified	2,189,016.50	2,306,475.14	2,247,745.82
	33.84%	38.75%	36.36%

UNS Electric, Inc.
Normalization of Unclassified Overtime Expense
Test Year Ended June 30, 2006

	2004	2005	2-Yr Average
Overtime Charged Directly to O&M - Unclassified	25,090.86	24,644.60	24,867.73
Regular Wages Charged Directly to O&M - Unclassified	1,064,548.36	1,034,695.64	1,049,622.00
	2.36%	2.38%	2.37%

UNS Electric, Inc.
Normalization of Non-O&M Account Overtime Expense
Test Year Ended June 30, 2006

	2004	2005	2-Yr Average
Overtime Charged Directly to Non-O&M Accounts	687,070.52	808,577.16	747,823.84
Regular Wages Charged Directly to Non-O&M Accounts	3,600,100.47	4,158,892.95	3,879,496.71
	19.08%	19.44%	19.28%

Note: Overtime expense is being included in cost of service for the test year based on the average overtime rate for the 2-yr period ended December 31, 2004 - 2005 applied to regular Classified and Unclassified wages direct charged to O&M as well as to Non-O&M accounts. The Overtime adjustment is being distributed across FERC accounts based on Test Year Payroll by Function-Classified and Unclassified wage distribution.

This schedule was included in UNS Electric's Payroll adjustment workpapers

ATTATCHMENT

RCS-10

IN ITS

ENTIRETY IS

CONFIDENTIAL

Parcell

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED FINANCING	DOCKET NO. E-04204A-06-0783

SURREBUTTAL

TESTIMONY

OF

DAVID C. PARCELL

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

AUGUST 24, 2007

TABLE OF CONTENTS

I. INTRODUCTION

Q. Please state your name and address.

A. My name is David C. Parcell. I am President and Senior Economist of Technical Associates, Inc. My business address is 1051 East Cary Street, Suite 601, Richmond, VA 23219.

Q. Are you the same David C. Parcell who filed Direct Testimony on behalf of the Commission Staff in this proceeding?

A. Yes, I am.

Q. What is the purpose of your current testimony?

A. My current testimony is Surrebuttal Testimony in response to the Rebuttal Testimony of UNS Electric witness Kentton C. Grant.

Q. What aspects of Mr. Grant's Rebuttal Testimony do you respond to in this Surrebuttal Testimony?

A. My Surrebuttal Testimony responds to the following general areas of Mr. Grant's Rebuttal Testimony:

Cost of Common Equity; and,

Financial Integrity/Capital Attraction of UNS Electric.

II. COST OF COMMON EQUITY

Q. What are the primary differences in your cost of equity recommendations and the cost of equity recommendations of Mr. Grant?

A. The primary difference in our respective cost of equity analyses revolves around the top ends of our Capital Asset Pricing Model ("CAPM") analyses. As I indicated in my Direct

Testimony (Page 31, lines 26-28) and as Mr. Grant acknowledges in his Rebuttal Testimony (Page 21, Lines 12-14), our respective Discounted Cash Flow ("DCF") results are very similar. In addition, our CAPM analyses produce similar results, except for the upper end of the ranges, as follows:

	DCF	CAPM
Parcell	9.50%-10.50%	10.00%-10.50%
Grant	9.70%-10.50% (10.4% median)	9.80%-11.20% (10.5% median)

This indicates that Mr. Grant and I agree with regard to our DCF results and most of our CAPM results. In addition, Mr. Grant's proposal to add 60 basis points to his cost of equity conclusions for his proxy group is unnecessary, as I indicated in my Direct Testimony.

Q. What are your comments about Mr. Grant's CAPM methodology and his comments on your CAPM methodology in his Rebuttal Testimony?

A. As I indicated in my Direct Testimony (Page 32, Lines 8-16) and as Mr. Grant acknowledges in his Rebuttal Testimony (Page 21, Lines 22-26), the primary difference in our respective CAPM methodologies is his use of an equity risk premium (7.1 percent) that relies exclusively on the arithmetic means of common stock returns and bond returns over the period 1926-2005.

Q. Mr. Grant claims, on pages 21-22, that it is appropriate to use only arithmetic returns, and ignore geometric (compound) returns in deriving the risk premium component of the CAPM. Do you have any comments on this claim?

A. Yes, I do. What is important is not what Mr. Grant and I believe, but what investors rely upon in making investment decisions. It is apparent that investors have access to both types of returns, and correspondingly use both types of returns, when they make investment decisions.

In fact, it is noteworthy that mutual fund investors regularly receive reports on their own funds, as well as prospective funds they are considering investing in that show only geometric returns. Based on this, I find it difficult to accept Mr. Grant's position that only arithmetic returns are considered by investors and, thus, only arithmetic returns are appropriate in a CAPM context. I note that I provided additional comments on this point in my Direct Testimony.

Q. Mr. Grant also takes issue with your comparable earnings analysis. Do you have any response to his assertions?

A. Yes, I do. Mr. Grant apparently believes that, if electric utilities, such as UNS Electric, have and are earning returns on equity of over 10 percent and simultaneously are enjoying a market-to-book ratio of about 150 percent, then the earned levels represent the cost of capital for the electric utilities. I disagree with this position. Investors know that the vast majority of utilities are regulated based upon the book value of their assets (i.e., rate base) and their liabilities (i.e., capitalization). It is logical and intuitive that investors would only pay a stock price that substantially exceeds book value for a utility if there is an expectation that the company is earning a return that exceeds its cost of capital. Mr. Grant ignores this in his Rebuttal Testimony.

Q. Mr. Grant also asserts, on pages 23-24, that you did not take into account any "company-specific risk factors" in your cost of equity recommendation. Do you have any response to this assertion?

A. Yes, I do. The primary "Company-specific risk factor" that Mr. Grant cites is the "size" of UNS Electric. Mr. Grant apparently believes that UniSource Energy's decision to maintain UNS Electric as a separate subsidiary, in contrast to merging it into Tucson Electric Power and/or UniSource Energy, should have the effect of raising its cost of equity. I disagree with this assertion. UNS Electric does not raise equity capital in the marketplace; rather it is raised by UniSource Energy based on the combined financial strength of all of its operations. If UNS Electric and every other subsidiary of UniSource Energy received a higher cost of equity due to their respective "small" sizes, each subsidiary, as well as UniSource Energy as a whole, would earn an excessive return.

This point is verified by UNS Electric's response to STF 4.3, which indicates that UniSource Energy Services ("UES") provided the cash investment portion of the purchase of the Citizens Utilities properties that became UNS Electric. This response also indicates that UES was an "intermediate holding company formed by UniSource Energy Corporation," apparently for the purpose of obtaining the Citizens properties in Arizona and for ownership of UNS Gas and UNS Electric. This response further indicates that UES obtained the cash it infused into UNS Electric from UniSource Energy. Thus, the link between the financing of UNS Electric and UniSource Energy is demonstrated.

In addition, the response to STF 4.9 verifies that UES is "listed as the guarantor in the 2003 sale and purchase agreement for $60 million of long-term notes and in the 2006 revolving credit agreement (as amended) with a syndicate of banks." This also demonstrates the financial linkage between UNS Electric and UES/UniSource Energy.

Finally, the response to STF 4.19 indicates Mr. Grant's acknowledgement that the "size impact on risk of UNS Electric . . . would be reduced if UNS Electric were merged into Tucson Electric." This indicates that this risk factor is within the control of the management of UniSource Energy.

Q. Mr. Grant also claims, on page 24, lines 1-7, and again on page 26, lines 21-27, that your cite of a 2003 Standard and Poor's report is no longer relevant. Do you have any response to this assertion?

A. Yes, I do. The source of the 2003 Standard & Poor's ("S&P") report is UNS Electric's response to STF 4.1, which requested "all reports by rating agencies" that describe the acquisition of UNS Electric by UniSource Energy. Since there have been no subsequent descriptions of the Company, it is evident from the S&P reports supplied by the Company in its DR response that S&P does not perceive that UNS Electric's financial status has changed since the cited report was prepared. The absence of any modification of these quotes by S&P is indicative that this agency's position of the Company has not changed since the cited report.

Q. Mr. Grant claims, on pages 24-25, that UNS Electric does not have investment-grade debt. Do you have any comments on this?

A. Yes, I do. UNS Electric's only debt is $60 million in notes issued to finance the Arizona Citizens properties. The notes were "issued pursuant to a private placement to institutional investors in 2003" (response to STF 4.12). Thus, these notes were issued to finance the purchase, which is a different scenario than most utility note issues.

III. FINANCIAL INTEGRITY/CAPITAL ATTRACTION

Q. Mr. Grant claims, on page 26, lines 7-17, that UNS Electric would not likely earn the return you recommend as a result of recommendations of other Staff witnesses. Do you have any response to this?

A. Yes, I do. The respective recommendations of other Staff witnesses in this proceeding reflect their own recommendations based upon their own analyses of UNS Electric's application and their own implementation of proper rate-making standards. To the extent that the Commission adopts any or all Staff recommendations, this is reflective of regulatory acceptance of the positions taken by Staff. Any corresponding reduction in the Company's potential earned rate of return would thus be appropriate from a regulatory and rate-making standpoint.

Q. Are there any other factors that impact the "financial metrics" of UNS Electric?

A. Yes, there are. When UniSource Energy purchased what is now UNS Electric in 2003, it agreed to a "rate freeze" that is still in effect. The response to STF 4.14 acknowledged that "the Company's earnings and cash flow have been negatively impacted over the period 2004 through 2006, and are expected to remain at depressed levels until rate relief is granted in this docket (assumed to occur in 2008 in this exhibit)." I note that Mr. Grant does not acknowledge the rate freeze and its impact on the Company's financial metrics when he describes the "financial integrity" of the Company.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

Radigan

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED. FINANCING	DOCKET NO. E-04204A-06-0783

SURREBUTAL

TESTIMONY

OF

FRANK W. RADIGAN

ON BEHALF OF

THE ARIZONA CORPORATION COMMISSION,

UTILITIES DIVISION STAFF

AUGUST 24, 2007

TABLE OF CONTENTS

EXECUTIVE SUMMARY
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-0783

CUSTOMER CHARGES – Based on a revised cost of service study, the Company has revised its proposed customer charges and now proposes a charge of $7.70 per month for the Residential Class and $12.00 per month for the Small General Service Class. These charges are in line with those that I proposed in my original testimony. Accordingly, the customer charge for the Residential Service Class should be increased from $6.50 per month to $7.50 per month and the charge for the Small General Service Class should be increased from $10 per month to $12 per month.

PURCHASED POWER ALLOCATION - The Company has still not provided any evidence that shows that purchased power should be allocated on other than a cent per kWh basis.

INCLINING BLOCK RATE STRUCTURE – Given the relatively small recommended rate increase and increases in the customer charge that Staff is recommending, I do not believe the current case presents the best situation for introducing an inclining block rate structure. The Company has not provided any new evidence to show that it is imperative or necessary at this time to introduce an inclining block rate structure. Absent such a showing, I urge rejection of the Company's proposal.

MANDATORY TIME OF USE ("TOU") RATES – The Company continues to argue for Mandatory TOU rates for new customers but has failed to provide any cost justification for it. Instead, it argues that it will be beneficial in the long term. While this may be true, it must still be cost justified and until such time that the Company provides evidence showing that it is, its position should be rejected.

DEMAND CHARGES FOR LARGE GENERAL AND LARGE POWER SERVICE - The Company continues to argue to lower the demand charges for large commercial customers taking service at less than 69 kV but does not have any cost data to support the proposal. Absent the showing of cost of service data that the demand charge should be lowered, the Company's position should be rejected.

MERGER OF MOHAVE AND SANTA CRUZ RATES - In my original testimony, I recommended a more tempered elimination of the rate differential between Mohave and Santa Cruz Counties. The Company's Rebuttal Testimony provides no new evidence that convinces me that I should alter my position.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services regarding the electric utility industry and specializing in the fields of rates, planning and utility economics. My office address is 120 Washington Avenue, Albany, New York 12210.

Q. Are you the same Frank Radigan that previously filed testimony in this proceeding?

A. Yes. I am appearing on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. What is the scope of your Surrebuttal Testimony?

A. I will address certain issues raised by Company Witness D. Bentley Erdwurm in his Rebuttal Testimony dated August 14, 2007. Specifically, I address his recommendations on 1) the revised customer charges, 2) the allocation of purchased power, 3) the implementation of an inclining block rate structure, 4) the implementation of mandatory time of use rates, 5) his justification for decreasing the differential in the demand charges for large general service customers, and 6) his proposal to merge the rates of Mohave County and Santa Cruz County customers.

A. Customer Charges

Q. Please comment on the company's proposed customer charge increases.

A. In Mr. Erdwurm's Rebuttal Testimony, he provides results of the cost of service study that eliminate line transformers from the calculation of the customer charge (Erdwurm Rebuttal Testimony, pages 2-6). The new study results in what Mr. Erdwurm calls a "bare bones" customers charge and he now recommends a $7.70 per month charge for the

Residential Class and a $12.00 per month charge for the Small General Service Class. These charges are in line with those that I proposed in my original testimony - a customer charge for the Residential Service Class of $7.50 per month and a customer charge for the Small General Service Class of $12 per month and should be approved.

B. Power Purchase Allocation

Q. Please discuss the Company's objection to the Power Purchase Allocation.

A. Company Witness Erdwurm continues to opine for an allocation of purchased power costs on an Average and Peaks Method (Erdwurm Rebuttal, pages 6-9). The Average and Peaks Method is made up of two components: an average demand component (with a percentage weight of the system load factor) and a peak demand component (with a percentage weight of one minus the system load factor). Mr. Erdwurm urges this method and rejects the energy allocation that I recommended in my original testimony. Mr. Erdwurm states that the Average and Peaks Method recognizes the importance of demand and energy when determining the costs to serve customers (Erdwurm Rebuttal, page 8). Mr. Erdwurm uses purchased power costs of Tucson Electric Power ("TEP") to develop a split of costs which he then applies to the purchased power contract that the Company has with Pinnacle West Capital Corporation (Erdwurm Rebuttal, pages 6-7).

The contract with Pinnacle West Corporation is the Company's power supply contract. It has no provision for demand charges or any segregation of charges by time of day, month or season. It is merely an energy charge. However much Mr. Erdwurm tries to reverse engineer this energy charge into demand and energy components, the simple fact remains that the purchased power charge is purely volumetric. The Company has provided no credible evidence to show that the Average and Peaks Method should be used in this case.

C. Inclining Block Rate Structure

Q. Please discuss the Company's proposal for an inclining block rate structure for the Residential and Small General Service Rate Classes.

A. The Company continues to urge acceptance of an inclining block rate structure (Erdwurm Rebuttal, pages 9-11). Casting aside my concerns about rate impacts, Mr. Erdwurm states that if conservation is an important goal to the Commission, then my argument of balancing conversation goals with bill impacts is against policy.

My arguments in my initial testimony properly balanced the goals on increasing energy conservation with other rate design changes being made. The reasoning is quite simple. I recommended against consolidation given the combination of the level of rate increase being recommended, the fact that power supply is being unbundled from delivery charges, the amount of the rate increase being recovered in the customer charge and the fact that I was recommending that the Santa Cruz and Mohave rates not be consolidated at this time. To do so would result in some customers getting rate decrease and others getting large rate increase. As most of the other elements of the rate design were determined to be more important than the introduction of inclining block rates at this time, I see no quantitative evidence in Mr. Erdwurm's testimony that cause me to change my mind in this regard.

D. Time of Use Rates

Q. Please address the issue of mandatory Time of Use Rates ("TOU Rates").

A. The Company continues to propose mandatory TOU rates even though he admits that my reservation about implementing a mandatory TOU rate should consider cost-benefit analyses (Erdwurm, page 12). Mr. Erdwurm takes this position because he states he is looking at the problem from a long term perspective. He states that even though a cost differential exists today between TOU and non-TOU meters, this differential should eventually disappear. He states that some cross subsidization exists already so this factor should not be an impenetrable barrier to implementing TOU rates.

The Company admits that it provided no cost justification for its proposal in its original case and does not provide any in its rebuttal testimony. Thus, in both the short and long term, there is simply no evidence that mandatory TOU meters are costs effective.

E. Demand Charges for Large General Service and Large Power Service

Q. Please discuss the Company's proposed demand charges for Large General Service and Large Power Service.

A. In his Rebuttal Testimony Company witness Erdwurm states that the differential in demand charge for services over 69 kW and under 69 kV is too high. Mr. Erdwurm admits that he has no study to determine a more exact differential but he notes that the differential for similar service at Arizona Public Service Company is almost half of the one that exists here. Mr. Erdwurm recognizes that though he was unable to provide results from a specific study, he asks that Staff reconsider its position based on the information given about Arizona Public Service (Erdwurm Rebuttal, page 14).

Eliminating a large differential for similar service is a noble goal but using the cost figures for another utility whose rate structure is not being examined in this case is not proper justification. UNS transmits power at 115 kV and 69 kV. On the UNS system there is a variety of 69 kV substations transforming power down to a variety of different voltages. Without a study, one cannot determine which of these lower voltages the majority of large commercial customers are taking power from or what the cost differential might be. For example, a large commercial customer could take service from a 13.8 kV line and should pay for not only the transformation of power but for the distribution of power across many miles of distribution lines. Without a study, it is impossible to tell how much equipment on the other side of the step down transformer is being used by the large commercial customers. Rather than guess what the differential should be, a UNS specific cost of service study should be developed and the issue be raised in the next rate proceeding.

F. Elimination of Separate Rates for Mohave and Santa Cruz

Q. Please discuss the Company's proposal to eliminate separate rates for Mohave and Santa Cruz Counties.

A. In Rebuttal Testimony Company witness Erdwurm urges combining the rates for Santa Cruz and Mohave at this time. Mr. Erdwurm characterizes my reluctance to fully meld the rates for the two Counties as being hypersensitive to rate changes (Erdwurm Rebuttal, page 15).

Mr. Erdwurm is incorrect in his assertion that I want to continue the status quo. In my original testimony I proposed that the customer charges for both counties be increased but not the energy charges. To do so would cause a rate decrease for some Santa Cruz customers. I didn't want this to happen since rates for the utility as a whole were increasing and I thought that was an improper price signal. Instead, I suggested that the differential be eliminated over two rate cases. Mr. Erdwurm has presented no factual evidence to change my mind.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

McNeely-Kirwan

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
Commissioner
GARY PIERCE
Commissioner

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED FINANCING	DOCKET NO. E-04204A-06-0783

SURREBUTTAL

TESTIMONY

OF

JULIE MCNEELY-KIRWAN

PUBLIC UTILITIES ANALYST II

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

AUGUST 24, 2007

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EXECUTIVE SUMMARY
UNS ELECTRIC, INC.
DOCKET NO. E-04204A-06-743

This Surrebuttal Testimony addresses issues raised by UNS Electric, Inc., in its Rebuttal Testimony, including the CARES discount, the Medical CARES discount and Medical CARES disconnections.

1. Staff recommends that the current discount structures for CARES and Medical CARES be retained.

2. If the current discount structure is retained, Staff recommends that the language of the website, and other UNS Electric marketing materials, be clarified to more clearly describe the discounts available under the CARES and Medical CARES programs.

3. Staff recommends that Medical CARES participation be reported separately in UNS Electric's CARES semi-annual reports.

4. Staff also recommends that any disconnections of Medical CARES customers for non-payment be reported in the CARES semi-annual reports, and that the Company should include explanations for why the reported disconnections do not violate the provisions of Arizona Administrative Code R14-2-211.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Julie McNeely-Kirwan. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Have you previously filed testimony in this docket?

A. Yes. I filed Direct Testimony addressing UNS Electric's CARES and Medical CARES programs and discounts. My testimony also discussed concerns regarding disconnections of Medical CARES customers.

Q. What is the subject matter of this Surrebuttal Testimony?

A. This Surrebuttal Testimony will address the CARES program discounts, including the new Medical CARES discount proposed by UNS Electric in its rebuttal testimony. My testimony will also discuss clarifying disconnect procedures to ensure that Medical CARES customers dependent upon medical equipment are not disconnected, in accordance with the provisions of Arizona Administrative Code R14-2-211.

CARES DISCOUNT

Q. Do you agree with testimony by UNS Electric that the current CARES and Medical CARES discount structures should be replaced with flat discounts?

A. No. The current CARES and Medical CARES discount structures provide incentives to conserve that are not available under the proposed flat rate discounts.

Q. Would the increased Medical CARES discount proposed by UNS Electric address all of Staff's concerns regarding the proposed discount changes for CARES and Medical CARES customers?

A. No. While increasing the flat rate discount for Medical CARES customers (from $8.00 to $10.00) would lessen bill impacts on Medical CARES customers, increases for Medical CARES customers with average usage would remain disproportionate. The new discount structure would also lessen incentives to conserve. Staff recommends that the current discount structures for CARES and Medical CARES be retained.

Q. Do you agree with the testimony of D. Bentley Erdwurm, on page 16 of his Rebuttal Testimony, that the current CARES discount requires CARES customers to "use more energy in order to receive a needed discount"?

A. No. Under the declining tiered structure currently provided by UNS Electric, all CARES customers receive discounts with built-in incentives to conserve. Customers using the least amount of energy receive the highest percentage discounts (30%) on their entire bills, while customers using more energy receive progressively lower percentage discounts (20%, 10% or a flat $8.00 discount). CARES customers using 1,001 kWh, or more, would have $8.00 taken off the bill, and would receive a discount of less than one percent.

Q. Is it Staff's understanding that RUCO supports the Company's proposed changes to the CARES discount?

A. Yes. Ms. Diaz Cortez, of RUCO, states on page 5 of her Additional Direct Testimony that RUCO supports the Company's proposed changes to the CARES discounts. Ms. Diaz Cortez also states that under the current rate structure "only the largest users receive the maximum benefits from the CARES discount."

Q. Does Staff concur with RUCO's testimony in this matter?

A. No. The actual dollar discount on a CARES or Medical CARES bill varies depending on the level of usage and the discount applicable to that level of usage. Generally, discounts under the current structure range between $6.00 and $12.00 on a regular CARES bill. Regardless of the discount, the total bill always increases as usage increases. Customers with the higher usage levels receive both lower percentage discounts and higher bills than customers with lower usage.

Q. Does Staff have any recommendations concerning the marketing of the CARES discount program?

A. Yes. If the current discount structure is retained, Staff recommends that the language of the website, and other UNS Electric marketing materials, be clarified to more clearly describe the discounts available under the CARES and Medical CARES programs. It should be clearly indicated that the level of discount *for the entire bill* is determined by where the total monthly usage falls in relation to specific cutoffs: 300, 600 or 1,000 kWh for regular CARES customers, or 600, 1,200 or 2,000 kWh for Medical CARES customers. (For example, a regular CARES bill showing total usage of 300 kWh would be discounted, in its entirety, at 30%, while a regular CARES bill showing total usage of 301 kWh would be discounted, also in its entirety, at 20%.)

Q. Does Staff have any recommendation concerning CARES reporting and disconnections of Medical CARES customers?

A. Yes. Staff recommends that Medical CARES participation be reported separately in UNS Electric's CARES semi-annual reports. Separate reporting will indicate whether efforts to expand Medical CARES participation are succeeding. Staff also recommends that any disconnections of Medical CARES customers for non-payment be reported in the CARES semi-annual reports, and that the Company should include explanations for why the reported disconnections do not violate the provisions of Arizona Administrative Code R14-2-211.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

Young

BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
KRISTIN K. MAYES
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IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND REQUEST FOR APPROVAL OF RELATED. FINANCING	) DOCKET NO. E-04204A-06-0783

SURREBUTTAL TESTIMONY

OF

BING E.YOUNG

PUBLIC UTILITIES ANALYST IV

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

AUGUST 24, 2007

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EXECUTIVE SUMMARY
UNS ELECTRIC, INC.
DOCKET NO. E-904204A-06-0783

This Surrebuttal Testimony addresses issues raised in the Rebuttal Testimony of Mr. Thomas G. Ferry relating to Staff's proposed elimination of free footage allowances for new construction. The Surrebuttal Testimony continues to support elimination of the free footage allowance.

I. INTRODUCTION AND STATEMENT OF WITNESS QUALIFICATION

Q. Please state your name, occupation, and business address.

A. My name is Bing E. Young. I am a Public Utility Analyst IV employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Have you previously filed testimony in this docket?

A. Yes. I filed Direct Testimony addressing UNS Electric's Rules and Regulations and Line Extension policies.

Q. What is the subject matter of this Surebuttal Testimony?

A. My Surrebuttal Testimony will address the line extension tariffs and Staff's proposed elimination of the free footage allowance which was discussed in the Rebuttal Testimony of Mr. Thomas J. Ferry.

Q. Could you please discuss Mr. Ferry's Rebuttal Testimony related to the line extension tariffs?

A. Yes. In his Rebuttal Testimony, Mr. Ferry states that I was incorrect in my statement that the Company was proposing an increase in the free footage allowance. Specifically, Mr. Ferry testifies that:

> Subsection 6.2.a of the Rules and Regulations was changed to allow only one span of wire from existing facilities to the customer's point of service. The Company suggested reduction in the service line extension policy which currently allows 150 feet of service wire and one carryover pole. This change would recognize that each customer will have a service drop; but if an individual desires

> to locate their point of service further from the lines than one span, they should pay for the longer line. In Subsection 9.D. of the Rules and Regulations the Company proposed combining the current distribution line footage allowance of 400 foot (sic) with a service allowance of 100 feet for the total of 500 foot per customer; the combined total being 50 foot and one carryover pole less than what is currently allowed.

Mr. Ferry appears to testify that while UNS has given 100 feet more of free allowance to customers on one hand (as part of Section 9 of the Proposed Line Extension Rules), UNS has at the same time proposed taking away other allowances that are currently given to customers (as part of Section 6 of the Proposed Service Lines and Establishment Rules), since under the proposed rule, there is "50 foot and one carryover pole less" than what customers are currently allowed.

Staff does not know whether UNS believes that the 100 feet of extra allowance to customers "nets out" the things that have been taken away. In his Direct Testimony, Mr. Ferry did not indicate that new customers were to lose anything along with the increase in free footage allowance as part of the revised tariffs. In reviewing Section 6.2.a of the new rules, there is nothing obvious in the red-lined version to indicate that this rule constitutes a significant policy change, and one which would balance out the increase in free footage allowance. To the extent that there is some sort of proposed offset to the proposed extra 100 feet of free allowance proposed, this was clearly not spelled out in Mr. Ferry's Direct Testimony, nor is it obvious by a reading of the rule.

Q. Does Mr. Ferry's explanation of UNS's proposed Section 6.2.a of its Rules and Regulations (related to carryover poles and service drops) change Staff's recommendation related to the issue of the line extension tariffs?

A. No. Even if it were true (which Staff does not necessarily concede) that UNS' proposed revisions in Section 6 of the Proposed Service Lines and Establishments essentially nets out or balances out the changes UNS proposes for the increase in free footage allowance in Section 9, this is essentially a moot point, given Staff's position.

Staff agrees with Mr. Ferry's statement that "growth should pay for growth." Certainly one of the easiest and cleanest means by which we can assure that growth help pays for growth is to require developers and new customers to pay the *actual* costs that UNS must incur to extend its distribution system in order to provide service.

Given the astronomical growth rates of five to seven percent being experienced in both of UNS' service territories, it is difficult to imagine that Staff's proposed policy change of eliminating free footage allowances will have any "far-reaching, negative impact(s) on development in (UNS') service territories, " as Mr. Ferry has testified.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.